1 Top Canadian Renewable Energy Stock Yielding 7% to Buy in April

Description

Turmoil is engulfing stock markets around the globe, as the uncertainty surrounding the economic fallout from the coronavirus pandemic grows. Many industries have been hit hard by the fallout from the pandemic. Among the most harshly affected are airlines, retailers, hotels, and restaurant stocks. There is considerable speculation that the economic slump will turn into a recession deeper and longer than the Great Recession of just over a decade ago. If that occurs, companies with strong defensive characteristics will protect against uncertainty.

Among the top-rated defensive stocks are utilities, notably those that generate electricity. One renewable energy utility that has been punished by the market, losing 18% over the last month, is **Polaris Infrastructure** (TSX:PIF). Despite emerging headwinds, Polaris is very attractively valued, making now the time to buy.

Rising geopolitical risk

Polaris owns a portfolio of renewable energy assets in Nicaragua and Peru. Aside from the risks posed by the coronavirus and related economic fallout, it is Polaris's exposure to Nicaragua which is responsible for the sharp sell-off. Nicaragua has been torn by strife since early 2018, when protests against proposed pension and social security reforms swept the nation. Those — along with U.S. sanctions — plunged Nicaragua into an economic crisis. The International Monetary Fund (IMF) predicts that Nicaragua's 2019 gross domestic product (GDP) contracted by 5%.

Prior to the coronavirus pandemic, the IMF predicted that the Latin American nation's GDP would decline by just under 1% during 2020. There is every likelihood that Nicaragua's economy will contract by more than 5% because of the coronavirus. The sharp decline in tourism will have a sharp impact on Nicaragua's economy.

Government limitations on movement, travel bans, closed borders, and the enforced closure of non-essential services will have a considerable impact on tourism. In 2018, tourism was responsible for 11% of the Latin American nation's GDP.

Furthermore, the economies of Nicaragua’s two top trading partners, the U.S. and China have been ravaged by the pandemic, causing growth to significantly decline. That will lead to sharply lower consumption and demand for Nicaragua’s exports.

Since mid-March 2020, Nicaragua’s controversial leader President Ortega has not made any public appearances, broadcasts, or statements. That has triggered considerable speculation that he may be gravely ill with the virus or perhaps deceased. There is considerable uncertainty about how the nation will manage the pandemic and eventually return to growth.

Those factors will have impact electricity demand and hence earnings for Polaris’s 77-megawatt San Jacinto geothermal plant in Nicaragua. There are also fears about continued to unrest in the Central American country, which could see stricter controls and lower fixed electricity prices or even nationalization of the asset.

Perceived risk is overbaked

Much of the perceived degree of risk appears overblown, and the impact on Polaris won’t be as severe as believed. The renewable electricity utility also owns three operating run of river hydro electric plants in Peru. They have 20-year power-purchase agreements (PPAs) and will add up to US$9.9 million to Polaris’s annual EBITDA. Polaris has also forecast that its cash flow per share will grow by 8-15%, and debt will fall to 2.9 times EBITDA.

The substantial increase in earnings and cash flow will allow Polaris to reduce debt. It anticipates that debt will be around 2.9 times EBITDA for 2020, which is quite a conservative multiple for an electric utility.

That significantly reduces the risk posed by San Jacinto and Polaris’s dependence on San Jacinto.

Peru is a more stable jurisdiction than Nicaragua. Before the coronavirus pandemic the IMF forecast 2020 GDP growth of 3.6%. While Peru’s economy will be impacted by the considerable fallout from the pandemic, it will emerge in better shape than Nicaragua.

Looking ahead

Short-term headwinds abound, but after the latest market decline, Polaris is attractively valued. The renewable electricity utility’s move into Peru will reduce risk and boost earnings. While investors wait for the economy to recover and Polaris to rally, they will be rewarded by its dividend yielding a juicy 7%. That payment appears sustainable with it representing 40% of cash flow and 67% of net income.

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mattdsmith