This Dirt-Cheap Utility Stock Is Still a Compelling Opportunity

Description

The average Canadian utility stock offers stability, decent long-term potential, and an excellent moat to protect it from competition. After all, governments are heavily involved in the process, ensuring voters get treated fairly from local utilities.

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Investors who dig a little deeper can find some compelling opportunities in the utility stock space. While the rest of the sector gets all the attention, these fringe names are quietly doing their thing. They offer two kinds of growth potential. Firstly, they have the potential to increase the size of the business. As long as that's done correctly, the second kind of potential — an increasing stock price — should follow.

Let's take a closer look at such an opportunity in today's market, a solid utility stock that also happens to trade at a dirt-cheap valuation.

The skinny

Polaris Infrastructure (TSX:PIF) has a checkered past. The company originally used IMF financing to build the San Jacinto geothermal power plant project in Nicaragua before eventually agreeing to a major restructuring back in 2015. It even went as far as changing its name from Ram Power to Polaris Infrastructure.

Unfortunately, investors were focused on that rather than the company's excellent underlying asset. San Jacinto is one of Nicaragua's crown jewels, a renewable plant that provides 72 MW of energy to a country that desperately needs reliable power sources. It has a power purchase agreement with the national utility company that runs through 2029.

Some investors may have an issue with Nicaragua, a nation that doesn't have a great reputation for stability. Some worry San Jacinto might be taken over by the Nicaraguan government. I think that's unlikely. Such a move would effectively stop any foreign investment in the country — something no government wants.

The company has begun expanding in the region as well, including making an acquisition in Peru. The

Peruvian assets consist of three operational run-of-the-river hydroelectric projects that were completed in late 2019 and early 2020. There should be additional opportunities for more projects in Peru as well.

The opportunity

Despite growing earnings significantly now that the Peru assets are generating cash flow, Polaris shares continue to be insanely cheap. This utility stock is one of the cheapest in the entire sector. In fact, it's one of the cheapest stocks on the Toronto Stock Exchange in general.

The company projects it'll earn between US$1.60 and US$1.80 per share in free cash flow in 2020 — a number that shouldn't be impacted by COVID-19 one bit. That converts back to a range of $2.20 and $2.48 per share when we look at it in Canadian dollars.

Shares of this utility company trade at just over $13 each as I type this. That puts shares at just over six times expected free cash flow on the high end of the valuation. You won't find many stocks cheaper.

Remember, Polaris is small enough that even small acquisitions or development projects can have a big impact on the bottom line. The company's balance sheet is in good shape too, ensuring it'll have the financial flexibility to take on such projects.

Finally, let's talk about the dividend. This utility stock pays a US$0.60 per share annual dividend, an excellent payout. The current yield is 6.3%. And with a payout ratio of approximately 40% of free cash flow, investors don't have to worry about this distribution. It's solid.

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The bottom line on this utility stock

Polaris has it all. The company trades at an embarrassingly low valuation, offers excellent growth potential, and even gives investors a generous — and safe! — dividend while they wait.

I own this one in my own portfolio with a five- to 10-year investment horizon. I suspect patient investors will be very happy with this one over the long-term.

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