Why TD Bank (TSX:TD) Stock Is an Undervalued Bargain

Description

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) has long been one of Canada's favourite bank stocks. Boasting solid growth, rising dividends, and a massive U.S. business, it's one of the best-performing banks in the country.

Whereas other Big Six banks have limped along with earnings growth in the 2-5% range, TD has been a solid grower, often increasing its earnings by 9-10% year over year. It's no surprise, then, that TD Bank stock is more expensive than those of its Big Six peers.

Compared to a bank like **CIBC**, which trades at less than 10 times earnings, TD's P/E ratio of 11.76 can start to look steep. And it's true that if you take growth out of the equation, TD is a little pricey for a Canadian bank. However, as you're about to see, once growth is factored in, the bank is actually among the cheapest on the TSX.

The stock is fairly cheap by conventional metrics

Going by common valuation metrics like the price-to-earnings (P/E), price-to-sales (P/S), and price-to-book (P/B) ratios, TD Bank stock is very cheap. Its P/E ratio of 11.76 is below average for all TSX stocks, as are its P/S (3.5) and P/B (1.67) ratios. Few would deny that TD is cheaper than most stocks by these metrics, but some commentators have argued that the stock is overvalued, because it is more expensive than other *Canadian banks*.

On the surface, this claim has some validity. After all, the stock does cost more than its peers relative to sales, earnings, and book value.

However, when we factor projected growth into the equation, the claim ends up being much less plausible. The P/E-to-growth (PEG) ratio measures a stock's P/E ratio over its growth rate. Based on **Thomson Reuters** data, TD's PEG ratio is just 1.74, which is very low.

In contrast, CIBC and **Bank of Nova Scotia** have PEG ratios of 3.96 and 2.17, respectively. Going by the PEG ratio, then, TD is cheaper than those stocks.

It managed to grow last quarter, despite global trade tensions

The big question you need to ask yourself when looking at a stock's PEG ratio is whether the company can keep up its past growth. The ratio is meaningless if a company can't continue its historical growth into the future.

Fortunately, in TD's case, there is ample evidence that the company can continue growing at a decent rate. In its most recent quarter, the bank grew its earnings at 5% year over year.

In TD's most recent reporting period, there were significant global trade tensions stemming from disagreements between the U.S. and China. Among other things, this resulted in a major dropoff in Chinese exports to the U.S. in August.

That TD's U.S. operations managed to grow at 13% in such an environment is highly encouraging and speaks to the company's ability to grow, even when the broader economy is facing challenges.

Foolish takeaway

Canadian bank stocks are generally cheap — and with good reason. With tepid earnings growth and a relatively small domestic economy, most of them won't outperform over the long term. TD Bank is one of the few exceptions.

With strong profitability metrics, a high and growing dividend, and consistent earnings growth powered by U.S. retail, it's one of the few TSX banks that's cheap even when you factor in growth prospects.

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