Here's What Makes a TSX Stock Cheap

Description

No matter what it is that someone's buying, one thing we all need to know before we can make a purchase is the price of the object. Whether that's a burger from a restaurant, a new car from the dealership, or a stock on the **TSX**, it's almost impossible for a buyer to decide if they want something unless they know the price.

What are we referring to when we reference the price of a TSX stock?

Often beginner investors may think that the price of one individual share of the company has an effect on the valuation of the business as a whole. For example, a company with a stock price of $50 a share is more expensive than a stock that has a price of $10 a share.

While investors look at the price of the share to determine a company's value, it isn't the price alone that makes up the valuation of the business.

How price per share is determined

The price of a TSX stock is calculated by taking the price of one share and multiplying it by the number of shares outstanding for the company. This is why looking at just the stock price on its own is irrelevant.

A company with one billion shares outstanding and a stock price of $50 a share would have a total market value of $50 billion.

However, a business with only one million shares outstanding but a stock price of $100 (double that of $50) would have a total market value of just $100 million — substantially less than $ 50 billion.

So, the price of the TSX stock is just the total market value divided by the number of shares.

While this can be complicated, we can make it easier by calculating per-share figures. An example of the most common figure is earnings per share.

What price do we talk about when we say a TSX stock is cheap?

When we say a business is cheap, we are referring to a business's value. There are several ways to calculate the value of a business.

Most investors like to use an earnings ratio to determine how much a business is worth.

So, in general, a TSX stock trading for 10 times the amount of net income it earned last year is cheaper than a stock that is trading for a price 20 times the net income it earned in the same year.

Like everything else in investing, there are, however, different ways to calculate the value of a business. Price will always be given to you; it's the value of the business you have to consider to see if an investment is worth making.

Understanding prices and values for TSX stocks

So far, when talking about the prices for a TSX stock, I have referenced the market price, or market cap, of the business.

While there is nothing wrong with using this price, it doesn't tell the full story. In this day and age, almost every publicly traded stock has some type of debt.

Investors need to factor in this debt when considering the value of the stock. This is called the enterprise value; it represents the total cost of a company.

For example, If you saw a house that was worth $1 million and selling for that price, you may buy it.

However, if that same house was still worth $1 million, but there was $750,000 in debt that came with the house as well, would you still pay $1 million for it?

This is what enterprise value measures. When you buy a stock with a tonne of debt, you have to calculate what effect that has on the valuation of the business.

A TSX stock such as **Hydro One**, for example, has a market cap of $14.8 billion but an enterprise value of $19.9 billion.

Bottom line

Understanding how a stock is priced and the total value you have to pay for a company is crucial. It's a prerequisite to making any high-quality, long-term investment. If you don't know what you're paying to own a TSX stock, you can't accurately calculate the value.

So, make sure to do your due diligence to find the cheapest stocks possible.

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