2 Undervalued Canadian Stocks to Buy Right Now

Description

The Canadian stock market has outperformed its American peers in a recovery rally so far this year. The **S&P/TSX Composite Index** is up 16% year to date (YTD), making it the best-performing broader market index in North America today ahead of Mexico's **S&P/BMV IPC index's** 14.7% and the United States's **S&P 500** and **Dow Jones Industrial Average** indices, which hit record highs lately with YTD gains of 14% and 12.8% respectively.

While such record-breaking performances are plausible, as North America recovers from the pandemic, finding potentially undervalued TSX stocks to buy with new money today has become a tougher challenge. That said, there is one technique favoured by value-investing legend Peter Lynch that is still applicable in screening for potential bargain stocks right now — the PEG ratio.

In his 1989 book, *One Up on Wall Street*, Peter Lynch argued that the price-to-earnings ratio (P/E ratio) of any fairly priced company will equal its growth rate. Thus, if we account for the expected growth rate in a company's earnings (by dividing the P/E ratio with the company's expected future earnings growth rate), a fairly valued stock should have a PEG ratio equal to one. If the PEG is above one, the stock is overpriced, and it becomes undervalued if PEG falls below one. Mr. Lynch's methods and strategies at The Magellan Fund have produced market-beating results for decades.

Interestingly, there are some TSX stocks with a PEG ratio of less than 0.5 right now! The market may not be fully pricing their high growth prospects. Let's have a look at two of them.

A little-known gold producer set to double its return on equity

Australia-based **Perseus Mining** (TSX:PRU) is a $1.7 billion gold mining company with operations in Ghana and Côte d'Ivoire. The company's third mine, the Yaouré Gold Mine in Côte d'Ivoire, poured its first gold in December last year. It could cheaply produce over 200,000 ounces of gold annually by 2022 at an average all-in sustaining cost (AISC) of around US$734 per ounce.

With gold prices still holding firm near US$1,800 per ounce, Perseus Mining could become insanely profitable and grow its cash flows at a rapid pace.

Wall Street expects Perseus's annual revenue to grow by 18% for the year ending June 2021 before surging by a staggering 51.3% in fiscal 2022. But that is not the best part; the company could grow its normalized earnings per share for fiscal 2022 by 76.7% year over year.

Analysts expect Perseus to generate a positive 8% return on equity (ROE) for the current year, which ends in June, and a strong 100% increase in ROE to 16% is doable over the next 12 months. Moreover, given its strong free cash flow generation going forward, the company could initiate a dividend this year, with substantial dividend growth in 2022.

Becoming a dividend stock is a significant premium value attribute for any company. And a PEG ratio of 0.3 is screaming to investors that Perseus Mining stock is undervalued right now.

Oil giant to triple revenue and earnings in 2021

Calgary-based **ARC Resources** (TSX:ARX) stock price is trading near its 52-week high of $10.56, signaling some momentum in its valuation, but a PEG ratio of around 0.33 could mean the rally isn't done yet. There is more room for ARC Resources stock to run, as oil prices remain strong in 2021.

ARC Resources is a $7.2 billion company that explores, develops, and produces crude oil, natural gas, and natural gas liquids in Canada. Its annual revenue could triple in a 199% year-over-year growth to $3.5 billion by December 2021. This is possible after its merger with Seven Generations Energy, which makes ARC Resources Canada's sixth-largest oil and gas company.

Analysts expect ARC Resources's earnings before interest, taxes, depreciation, and amortization margins to expand from 48.4% in 2020 to 60% this year. The company could see a 271% surge in its normalized earnings per share this year. The best part is that annual free cash flow could triple to over $1 billion this year to support future dividend growth.

Investors will enjoy a 2.3% yielding dividend on top of potential capital gains as momentum persists, and the business posts stellar results in the near future.

Wall Street maintains a target stock price of $13.22 on ARC Resources stock, indicating a potential 26% upside over the next 12 months.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
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TICKERS GLOBAL

1. TSX:ARX (ARC Resources Ltd.)
2. TSX:PRU (Perseus Mining Limited)

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