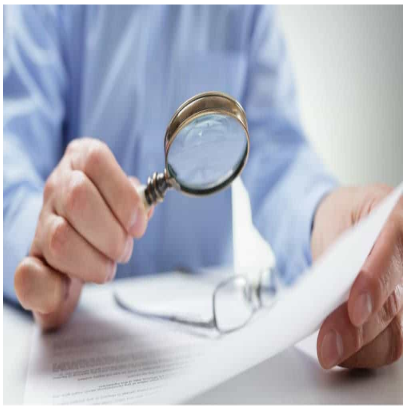

3 Ways to Find Undervalued TFSA Stocks

Description

Stocks are probably the best asset class for your Tax-Free Savings Account (TFSA). The long-term capital appreciation and exceptional dividend yields from blue-chip stocks could help you maximize the value of your account.

However, finding the right TFSA stocks is easier said than done. Here are three ways you can identify the most undervalued opportunities in this market.

Ratios

Valuation ratios are quick and easy tools to evaluate stocks and compare companies to their peers. The most popular ratio is the price-to-earnings (P/E) ratio, which indicates the company's earning power per dollar value of share price.

The P/E ratio also allows investors to compare stocks within the same industry.

At the time of writing, the **S&P/TSX Composite Index's** P/E ratio is 13.5. That means the average Canadian stock offers an earnings yield of 7.4% — slightly higher than the current pace of inflation. Any stock trading at a P/E ratio below this level is arguably undervalued.

Tourmaline Oil is an excellent example. The oil stock trades at a P/E ratio of 10, which implies an earnings yield of 10%. Investors looking for a TFSA stock on a discount should add this energy giant to their watch list.

Future earnings growth

The P/E ratio is an excellent valuation metric, but it doesn't account for a company's *future earnings potential.* For instance, a stock trading at a P/E of 60 today could be below 10 within nine years if its earnings grow at an annual rate of 30%.

This is why I prefer the P/E-to-growth ratio, or PEG ratio, for growth stocks. A PEG ratio below one implies the stock is undervalued based on its future growth rate.

Discount retailer **Dollarama** is an excellent example. The company's net income expanded 37% in its most recent quarter. Meanwhile, the stock trades at a P/E ratio of 30.7, which implies a PEG ratio of 0.83. If Dollarama continues to grow at this pace, the stock is undervalued at current levels.

Buybacks

Share repurchase or buyback programs are another sign of undervaluation. In fact, I consider these reward programs a "hidden dividend" for shareholders.

Consider energy transportation giant **Enbridge**. The stock offers a 6.4% dividend yield based on the current market price. However, the management team has already approved a share-repurchase program for 1,929,706 common shares this year. This program reduces the total outstanding shares by 1.5%. Effectively, Enbridge's total shareholder reward is 7.9% (dividend yield + buybacks).

Companies with enough cash flow to execute a buyback program are certainly worth a closer look. It's a clear indication that the management team believes the stock is undervalued. That's why TFSA stocks like Enbridge should be on your watch list.

CATEGORY

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3. TSX:ENB (Enbridge Inc.)
4. TSX:TOU (Tourmaline Oil Corp.)

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