Top Undervalued Canadian Stocks of 2023

Description

An undervalued stock is a stock whose trading price appears to be lower than the company's intrinsic value. The company underlying the stock is typically in good financial standing, with both a solid earnings history and future growth prospects still ahead.

But whether from poor investor sentiment or an overall market correction, the share price appears to be wrong – that is, it does not reflect the company's true value. This mispricing might give astute value investors a chance to buy a high-quality stock at a significant discount.

As good as that sounds, investing in undervalued stocks comes with a steep challenge: you must find them first. Below, we're going to show you how to find undervalued stocks, as well as name a few stocks that are currently trading under their intrinsic value.

What is an undervalued stock?

An undervalued stock is a stock whose underlying company appears to have a solid financial record—for example, the company is profitable, with low or no debt, healthy free cash flow, and a stable earnings history—but whose trading price is much lower than what analysts and investors might expect.

Undervalued stocks are sometimes developing companies with long-term growth prospects, but whose prices are trading below that of its peers and competitors. More often they're well-established companies whose stocks are underestimated or underappreciated by investors, even though their underlying revenue and earnings haven't changed.

Generally speaking, a good value stock will have the following characteristics:

- A well-established brand or well-known name with a track record of long-term growth.
- Unwavering profitability with stable cash flow and low or no debt.
- A clean record, that is, the company isn't involved in a scandal that threatens its financial future, nor does it depend on technology that's nearly obsolete.

- An intrinsic value that's higher than its share price.

What is intrinsic value?

Intrinsic value is a company's fundamental worth. You can calculate it by subtracting a company's assets (both tangible and intangible) by its liabilities. Or you can use financial metrics (such as P/E ratios) to compare stock prices to things like earnings and revenue.

Undervalued vs. Overvalued Stocks

Value investors believe a stock's intrinsic value is lower than its trading price. When they calculate the intrinsic value, they can see if the stock price matches the company's fundamentals, not just the whims of the market. A stock that trades *higher* than its intrinsic value could be considered *overvalued*, which might be a red flag. When the intrinsic value is lower than the stock price, however, the stock could be *undervalued*, which could signal a bargain.

Best undervalued Canadian stocks

There are plenty of undervalued stocks in Canada: you just have to know where to look. To help you get started, here are five of the best undervalued stocks trading today in Canada.

Undervalued Stocks	Market Cap	P/E Ratio	P/B Ratio	Possible Reasons for Price Drop
Shopify (TSX:SHOP) (NYSE:SHOP)	$543 billion	253.5	4.1	High inflation or concerns over a possible market recession.
Royal Bank of Canada (TSX:RY) (NYSE:RY)	$139 billion	11	1.8	Interest rate hikes, higher borrowing costs, or high inflation.
Constellation Software (TSX:CSU)	$39 billion	75.8	21.9	High inflation, an overall market correction, or poor investor sentiment over tech stocks.
Air Canada (TSX:AC)	$6.24 billion	-5.4	-5.4	Air travel restrictions (e.g., COVID-19 pandemic) or decline (e.g., recession).
CIBC (TSX:CM) (NYSE:CM)	$58 billion	9.2	1.3	Interest rate hikes (e.g., making mortgages more expensive) or a recession (e.g., a decline in loans).

Data updated as of October 5, 2022.

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Why would a stock be undervalued?

Stocks become undervalued for a few main reasons:

1. Bad news or quarterly reports

If a company misses quarterly earnings expectations, shares could plummet. Additionally, if a company has a massive recall on their products, or an executive is involved in a public scandal, share prices could drop considerably in a short period of time.

Depending on the news or earnings reports, these could be the easiest forms of undervaluing to diagnose. Be sure to do your own homework though to understand just how serious the bad news is, as not all companies can recover from a public scandal.

2. Sector cyclicality

Some stocks are cyclical, meaning their earnings and revenue follow economic cycles of expansion and contraction.

These cycles are an inevitable part of a healthy economy, but investors aren't always aware of this. When an economic downturn causes a company to lose revenue, investors might sell out, even if the company's intrinsic value hasn't changed much.

Examples of cyclical stocks include travel companies (airline and hotel), automakers, restaurants, retail stores, and tech companies.

3. Market crashes and corrections

When there's a stock market crash, bear market, or market correction, high-quality companies often start selling for lower prices. Because investors are sheepish during market downturns, they're reluctant to buy these stocks, even if the company still has intrinsic value.

How to find undervalued stocks

Finding undervalued stocks requires research, fundamental analysis, and patience—*lots* of patience. It can get tedious at times—especially when you're using financial metrics and ratios—and you'll often have to analyze numerous companies before you find a true value stock. To help you get there, here are three important steps to keep in mind.

1. Start with what you know

When you're evaluating stocks for the first time, it's a good idea to start with a handful of market sectors or industries you're already familiar with. For example, if you're a biologist, you might want to consider stocks that are within your field of expertise (or even adjacent to it) like genomics or biotech.

Not only does this give you a head start in your analysis, but it also groups companies with similar business models and products. This will make your evaluation more accurate. For example, two genomics companies will likely have similar debt ratios than, say, a genomics company and a mining company or bank.

2. Use financial metrics to find intrinsic value

Perhaps the most popular way to find value stocks is to use a handful of financial metrics, or valuation tools, to figure out the stock's intrinsic value. Once you have a good idea of the intrinsic value, you can compare it to the stock's price to determine if it is undervalued.

A *slew* of financial metrics can be used to find a company's 'true' value. But here's a quick breakdown of the three most popular.

Financial Metrics	What it is	How to Calculate it	How to Use it	Shortcomings
Price-to-earnings (P/E) ratio	A valuation tool that compares a company's stock price with its earnings per share (EPS).	Divide the stock's current share price by its most recent earnings per share (EPS).	Find the average P/E ratio for whatever sector your stock falls in. If your stock has a lower P/E than the average, it could mean it's undervalued. A higher P/E could mean it's overvalued.	P/E ratios have many limitations. It doesn't factor in debt, nor does it tell value investors about a company's growth prospects. To compensate for these shortcomings, use it with other financial metrics.
Price-to-book (P/B) ratio	A ratio that compares the stock's price with its book value (assets minus liabilities).	Divide the stock's current share price by book value per share.	You'll need a few comparable companies to make this work. Find the P/B ratio for the company you're evaluating along with some competitors. If your company has a lower P/B than others, it could be a sign it's undervalued.	Be sure to research the context of the type of company you're evaluating (i.e., it may be "cheap for a reason"). The P/B ratio can be quite useful for asset-heavy companies, like banks; it's less useful for companies with light assets, like tech companies.

Debt-to-equity (D/E) ratio	A ratio that compares a company's debts with its assets. It can tell you how effectively a company is using debt financing (i.e., if a company has too much or too little debt).	Divide a company'stotal debts byits shareholder's equity (assets minusliabilities).	A low debt-to-equity ratio means the company uses lessdebt to finance itsassets, whereas ahigher ratio means thecompany uses moredebt. Again, you shouldcompare your companywith similar ones, as asingle debt-to-equityratio won't mean much without a benchmark. If your company has a lower debt-to-equity ratio than similar companies, that could be a good sign it's undervalued.	Debt isn't always a bad thing. Often debt is used to finance growth and research, which could bring in more revenue in the future. A company could have a high debt-to-equity ratio while still being a good value.

Again, these are only three financial metrics you can use. Others include return on equity (ROE), earnings yield, dividend yield, current ratio, price/earnings-to-growth ratio (PEG), and cash flow.

3. Be sure it's not a value trap

Finally, pay close attention to value traps. These are stocks that appear to be on sale, but their lower prices *actually* reflect their deteriorating business. For example, a big-name retailer may be slow to adapt new technology, causing their business model to be outdated.

Why would someone buy undervalued stocks?

Investors buy undervalued stocks in the hopes that the market will eventually recognize the stock's intrinsic value. By buying the stock when the price is low, investors can make handsome gains when the stock price reflects the company's true value.

Should you invest in undervalued stocks in Canada?

Now is a great time to look for undervalued stocks in Canada. With the recent market correction in the Canadian stock market, as well as the bear markets in popular U.S. indexes, many high-quality companies have seen their stock prices tumble. While other stock investors are timid about buying, value investors are having a field day, gobbling up stocks that are trading far below their intrinsic worth.

But be cautious: finding undervalued stocks is one thing; for the market to recognize the stock is undervalued is another. Be sure the value stocks you're buying correspond to companies with solid financial footing, whose share prices are likely to rebound later. Use fundamental analysis with the financial metrics mentioned above to analyze the stock's revenue, earnings, assets, and debt. If the company appears to be in solid financial condition, the low stock price might be a bargain.

For investors who want more upside potential, you could also invest in growth stocks. These stocks are companies that are growing faster than the average company in their industry. They come with more risk, but also more reward: when you buy these stocks at a low price, and the company explodes in value, you can earn some handsome returns.

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
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3. NYSE:SHOP (Shopify Inc.)
4. TSX:AC (Air Canada)
5. TSX:CM (Canadian Imperial Bank of Commerce)
6. TSX:CSU (Constellation Software Inc.)
7. TSX:RY (Royal Bank of Canada)
8. TSX:SHOP (Shopify Inc.)

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