Price to Earnings Ratio Formula and Examples

Trade for **Good.**

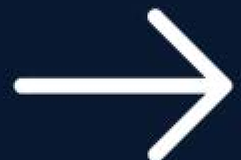
What Is the Price-to-Earnings (P/E) Ratio?

The price-to-earnings ratio is the ratio **for valuing a company** that measures its current share price relative to its earnings per share (EPS).

The price-to-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

P/E ratios are used by investors and analysts to **determine the relative value of a company's shares.**

Trade for **Good.**



KEY TAKEAWAYS

- A **high P/E ratio** could mean that a company's stock is **overvalued**.
- Companies that have no earnings or that are losing money do not have a P/E.
- **Two kinds of P/E ratios, forward and trailing P/E.**
- A P/E ratio holds the **most value** to an analyst when **compared against similar companies** in the same industry.

Trade for
Good.

P/E Ratio Formula and Calculation

The formula and calculation used for this process are as follows.

$$\text{P/E Ratio} = \frac{\text{Market value per share}}{\text{Earnings per share}}$$

To determine the P/E value, divide the current stock price by the EPS.

EPS comes in two main varieties.
TTM is a **trailing 12 months calculation**.
Guidance EPS is an estimate for the future.

Trade for **Good.**

Understanding the P/E Ratio

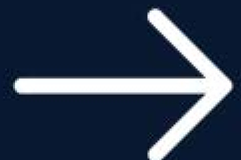
P/E is one of the most widely used tools by which investors and analysts **determine a stock's relative valuation**.

Analyst look at long-term valuation's
P/E 10 = avg over **10 years earnings**
P/E 30 = avg over **30 years earnings**

These measures are often used when trying to **gauge the overall value** of a stock index.

All Ordinaries PE is 17.4x since 1987, S&P 500 PE is 20x.

Trade for **Good.**



Forward Price-to-Earnings

The forward P/E uses future earnings guidance. This forward-looking indicator is useful for **comparing current earnings to future earnings** and helps provide a clearer picture of what earnings will look like.

There are inherent problems with the forward P/E,

- Underestimate earnings companies
- Or overstate the estimate

Trade for **Good.**

Limitations of Using the P/E Ratio

Like any other fundamental designed to inform investors as to whether a stock is worth buying, the PE ratio comes with a few limitations.

- Comparing the P/E ratios of different companies.
- **Valuations and growth rates** of companies may **often vary wildly between sectors**.

What Is a Good Price-to-Earnings Ratio?

Depending on the industry in which the company is operating, **some industries will have higher average price-to-earnings ratios**.

For example, a broadcasting companies has a P/E ratio of 12x, while a software company can have P/E of 60x.

To determine if whether a particular P/E ratio **compare** it to the average P/E of the **competitors within its industry**.

What Does a P/E Ratio of 15 Mean?

A **P/E ratio of 15** would mean that the current market value of the company is **equal to 15 times its annual earnings**.

If you were to hypothetically buy 100% of the company's shares, it would take 15 years for you to earn back your initial investment through the company's ongoing profits assuming the company never grew in the future.

Trade for **Good.**

Why Is the P/E Ratio Important?

The P/E ratio **helps investors determine** whether the stock of a company is **overvalued or undervalued compared to its earnings**.

If a company is trading at a high P/E ratio, the market thinks highly of its growth potential and is willing to potentially overspend today based on future earnings.