Valuation Ratios

January 22, 2024

Contents

1 Market Cap

1. A company's market cap is essentially the dollar value of all the company's shares, and is easily determined by multiplying the number of shares of a company by the current market price.

2. This can be a better indicator of a company's value and size than the financial statements are.

3. Companies are divided into four main categories in terms of their market cap:

   - **Micro cap** = Less than $250 million
     - This company does not recommend investing in micro caps as they are susceptible to pump and dump schemes.
   - **Small cap** = Between $250 million and $1 Billion
   - **Mid cap** = Between $1 Billion and $5 Billion
     - This is where some stability can be found and is where the fund mainly resides in terms of its investment spaces.
   - **Large cap** = More than $5 Billion
   - **Mega cap** = More than $200 Billion

4. Generally the smaller the market cap the more volatile and risky the stock is.

2 Dividend Yield Percentage

1. Dividend Yield Percentage is calculated by dividing the annual dividend per share amount by the current stock price. This amount is what you would get back on your money thanks to the stocks dividend if you bought the stock today.

2. Dividends can be ignored if you believe the price of a company's stock is going to increase, but for income investors such as a retiree who might not care as much about getting a return on the increase of a company's stock and who would rather get a check in the mail every quarter to help with their daily expenses, dividends can be a major factor in determining whether or not to purchase a company's stock.

3. Remeber that in order for your money to grow the dividend yield should be higher than the current interest rates. Be careful when you see dividend yields in the higher single digits and beyond as these can signal instability. Dividend yields above ten percent, with stock prices that do not increase at the same rate, are highly unsustainable and often will lead to a cancelation of the dividend payment all together (dividend trap).

3 Price-to-Earnings Ratio (P/E, ttm or trailing twelve months)

1. Is calculated by dividing the current stock price by the earnings per share (EPS) amount. The result is how many times you are paying for the earnings of the company. When using real EPS to calculate the ratio, it is known as trailing P/E or P/E ttm.

2. When using P/E to determine a value of a company, no P/E means the company has reported losses in the last twelve months. While this doesn't sound good, it could only be a temporary problem and shouldn't necessarily scare you away from purchasing a company's stock, for example if a company is in the middle of an expansion it is not unheard of to see losses reported in the middle of this process, however if the company was doing well before the expansion and there is no reason to think that these new avenues will change that, the lack of a P/E is often overlooked. A low P/E say less than 5% could be a very attractive sight, however it could also mean that tough times are ahead for that company. Look for stock with a low P/E such as 5-10%, as these coupled with good growth expectations could signal a major increase in stock price in the future. P/E of 11-18 % are midrange and signal that a company is pretty accurately priced in terms of its stock. High P/E's are rates of 19-40%, and these are typical in bull markets as the market is expecting earings to grow in the future, therefore the stock is price is increasing at a faster rate than the company's earnings are. A P/E above 40% signals that you are paying a lot for the company's earnings, you better hope that the company will increase earnings, because if it doesn't you will be paying a high price for low earnings. However, if it is expected that earnings will grow a lot in future, such as popular growth stocks do, than this could be a very good investment at the moment.

3. Value investors focus mainly on a company's P/E ratio as they are not interested in buying a super growth stock, but rather buying a company on a discount now.

4. There is also something called Forward P/E which is based not on a company's current earnings, but based on what market analysts predict a company will be earning in the future. Remember since it solely based on a prediction it should be used as such. Do not base buying a stock strictly on a high Forward P/E. If the forward P/E is lower than the trailing P/E it means that relative to the stock price the earnings per share will be higher in the future, future earnings will be greater than past earnings. If the Forward P/E is higher than the trailing P/E than the earnings per share relative to the stock preice will decrease and therefore you will be paying a higher price now for something that could be earning less in the future.

5. Growth investors tend to care only about the Forward P/e and ignore the trailing P/E altogether as they are only focused on the potential the company has in the market place.

4 Price-to-Earnings-to-Growth Ratio (PEG)

1. A company's PEG is essentially a refined version of the their P/E ration to include the growth of the company's EPS. The idea being that it tells you whether a company is overvalued or undervalued based not only on their earnings, but also based on the growth of the company. People who calculate PEG's rely either on comments by the company's managers, or an analysts prediction, so one should take PEG ratios with a grain of salt.

2. When using PEG's note that a company with a PEG of less than 1 means that it is undervalued and earnings could grow faster than the market expects, making it a good investment. A PEG of exactly 1 means that the market is correctly valuing a company. A PEG of more than 1 means that a company is overvalued, and may not be a good investment. The higher the number, the worse the investment. Also when using finviz, PEG's under 1 will be marked green, PEG's between 1 and 2 will be black (neutral), and PEG's over 2 will be marked red.

3. Ideally P/E, Forward P/E and PEG will all be green, but P/E and PEG may be more important.

5 Price-to-Book Ratio (P/B)

1. A company's P/B is calculated by dividing the current stock price amount by the shareholder's equity, the total value of the company's assets. The result is how many times you are paying for the total value of a company's assets.

2. As a general rule of thumb, when working with P/B's, a P/B of less than 1 implies that you are buying a company's stock below the value of it's assets and could signal a great bargain because if nothing more you could buy the company and sell its assets at a profit. A P/B of greater than 1 implies that you are buying a company at a higher price than the value of its assets. This is the typical situation, Amazon is valued for much more than simply what it owns. However, you should be careful with P/B ratios higher than 5, excpet in the case of brand recognition. P/B does not take the 'value' of a company's brand name into consideration, therefore company's with recognizable brand names will have higher P/B ratios.

3. One major problem with P/B's are that the value of the asset on the balance sheet might not be real or updated to current market circumstances.

6 Price-to-Sales Ratio (P/S) & Price-to-Cash Ratio (P/C)

1. You want both of these to be low. The lower the P/S and P/C, the more 'undervalued' the stock is.

7 Debt-to-Equity & Quick Ratios

8 Efficiency Indicators: Return on Assets, Return on Equity, Return on Investment

1. The higher these are, the more efficient the company is, however when comparing these numbers you must remain in the same sector of the market. Do not try to compare a company's ROA in the fast food industry with a company's ROA in the shoe industry.

9 Optionable, Shortable & Recom

1. Optionable means that the stock has options you can trade with. Look for stocks with yes under optionable in finviz.
2. Shortable means that this stock can be shorted.
3. Recom is the analysts mean recommendation. 1 is a strong buy, 2 is a buy, 3 is neutral or hold, 4 is a sell, and 5 is a strong sell, sell now.