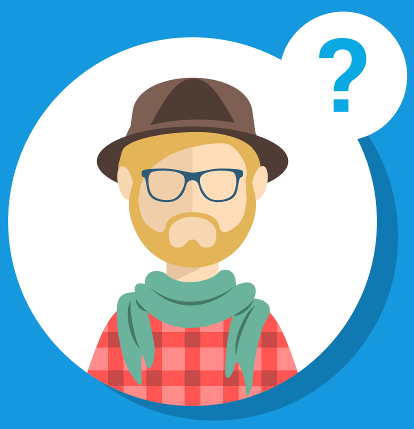
12:30



How can I estimate a company's future stock price and the compounding annual return?

John

We know!

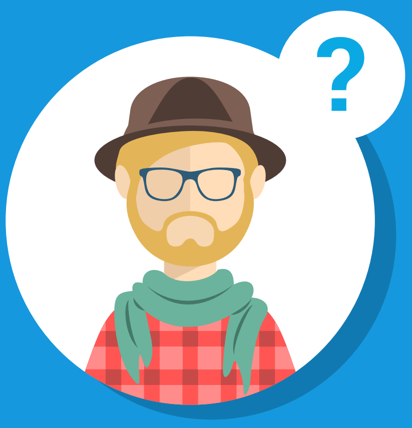
Tap on each step to find out more.

Step 1:
Calculate the future earnings and dividends using the Return on Equity ratio

Step 2:
Calculate the future stock price using the Price to Earnings ratio

Step 3:
Calculate total returns that include dividends

Step 4:
Calculate the compounding stock return from todays price to future price



Step 1: What is the Return on Equity ratio?

John

"Return on Equity" is defined as:

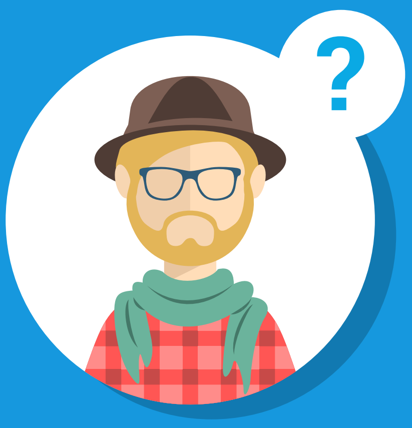
The amount of net income returned as a percentage of shareholders equity.

Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

How to calculate Return on Equity (ROE)?

For example, a company has equity of $500M and this years profit is $100M.

$$ROE = \frac{Profit}{Equity} = \frac{\$100M}{\$500M} = 20\ \%$$



But how to do I calculate future earnings using the Return on Equity calculation?

John

To calculate profit, turn the ROE equation around to:

Profit = ROE x Equity

Using Return on Equity to calculate Profit Estimate for one year:

$500M Equity

$100M Profit
Equity * ROE
$500 * 20 %

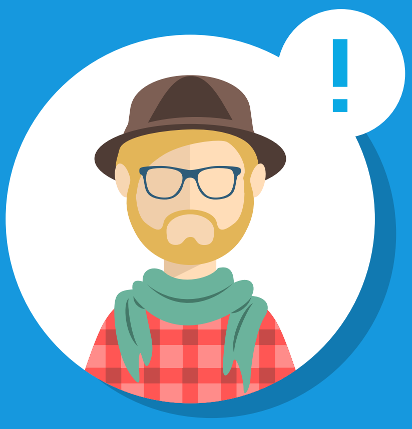
Profit split in half

$500M Equity

$50M Retained Earnings

$100M Dividend

Now future Equity has increased by $50M, by retaining half of the profit, to $550M



Yay! I get to keep some money as a dividend!

John

Using Return on Equity to calculate Profit estimate, over 10 years.

Remember, in this example, half of the profit is paid out as dividends each year.