Investment Valuation Ratios: Price/Book Value Ratio

A valuation ratio used by investors which compares a stock's per-share price (market value) to its book value (shareholders' equity). The price-to-book value ratio, expressed as a multiple (i.e. how many times a company's stock is trading per share compared to the company's book value per share), is an indication of how much shareholders are paying for the net assets of a company.

The book value of a company is the value of a company's assets expressed on the balance sheet. It is the difference between the balance sheet assets and balance sheet liabilities and is an estimation of the value if it were to be liquidated.

The price/book value ratio, often expressed simply as "price-to-book", provides investors a way to compare the market value, or what they are paying for each share, to a conservative measure of the value of the firm.

Formula:

$$\text{Price/Book Value Ratio} = \frac{\text{Stock Price per Share}}{\text{Shareholders' Equity per Share}}$$

Components:

$$\text{Price/Book Value Ratio} = \frac{\$67.44}{\$4{,}682.8/247.1} = 3.6$$

The dollar amount in the numerator, $67.44, is the closing stock price for Zimmer Holdings as of December 30, 2005, as reported in the financial press or over the Internet in online quotes. In the denominator, the book value per share is calculated by dividing the reported shareholders' equity (balance sheet) by the number of common shares outstanding (balance sheet) to obtain the $18.90 book value per-share figure. By simply dividing, the equation gives us the price/book value ratio indicating that, as of Zimmer Holdings' 2005 fiscal yearend, its stock was trading at 3.6-times the company's book value of $18.90 per share.

Investment Valuation Ratios: Price/Earnings Ratio

The price/earnings ratio (P/E) is the best known of the investment valuation indicators. The P/E ratio has its imperfections, but it is nevertheless the most widely reported and used valuation by investment professionals and the investing public. The financial reporting of both companies and investment research services use a basic earnings per share (EPS) figure divided into the current stock price to calculate the P/E multiple (i.e. how many times a stock is trading (its price) per each dollar of EPS).

It's not surprising that estimated EPS figures are often very optimistic during bull markets, while reflecting pessimism during bear markets. Also, as a matter of historical record, it's no secret that the accuracy of stock analyst earnings estimates should be looked at skeptically by investors. Nevertheless, analyst estimates and opinions based on forward-looking projections of a company's earnings do play a role in Wall Street's stock-pricing considerations.

Historically, the average P/E ratio for the broad market has been around 15, although it can fluctuate significantly depending on economic and market conditions. The ratio will also vary widely among different companies and industries.

Formula:

$$\text{Price/Earnings Ratio} = \frac{\text{Stock Price per Share}}{\text{Earnings per Share (EPS)}}$$

Components:

$$\text{Price/Earnings Ratio} = \frac{\$67.44}{\$732.5/247.1} = 22.8$$

The dollar amount in the numerator is the closing stock price for Zimmer Holdings as of December 31, 2005 as reported in the financial press or over the Internet in online quotes. In the denominator, the EPS figure is calculated by dividing the company's reported net earnings (income statement) by the weighted average number of common shares outstanding (income statement) to obtain the $2.96 EPS figure. By simply dividing, the equation gives us the P/E ratio that indicates (as of Zimmer Holdings' 2005 fiscal yearend) its stock (at $67.44) was trading at 22.8-times the company's basic net earnings of $2.96 per share. This means that investors would be paying $22.80 for every dollar of Zimmer Holdings' earnings.