The P/E Ratio

1. The P/E ratio is an example of a **valuation** ratio. It represents how much investors are willing to pay per dollar of earnings.
2. The higher the P/E ratio, the **more** investors are willing to pay for a company’s earnings.
3. How is the P/E ratio calculated? **Price per share (currently observed in the market divided by the Earnings per Share.**
4. If we say that a stock trades 25 times earnings, it means that investors are paying **$25** for every **$1** of earnings.
5. An example of a low P/E is around **10-15** . An example of a high P/E is **over 30 or 40**.
6. How is earnings per share (or profit per share) calculated? **The one year worth of profit (or Net Income) divided by the number of shares that the company has issued.**
7. List three different finance websites that post the P/E ratio: **Google Finance, Yahoo Finance, Morningstar**
8. Most websites show the **trailing** P/E. The P is always the current stock price. The E represents the earnings from the last 12 months.
9. A **forward** P/E is the current price divided by the forecasted (or predicted) next 12 months of earnings.
10. What is one example of a time when analyzing the P/E ratio does not make sense?

**­­­­­­­­­­The company has negative earnings, the EPS is very low (leads to exploding P/E), or the EPS includes extraordinary charges or gains, misleading the P/E.**

1. Why would an investor be willing to pay a premium, or in other words, a high P/E, for a company? **The company must have a valuable characteristic, like a valuable patent or high growth of earnings forecasted.**
2. True or **False**? The P/E alone tells investors if a stock is a good or bad investment.
3. A high P/E indicates that the market collectively is very **optimistic** about a company’s future. A low P/E indicates that the market collectively is **pessimistic** about a company’s future.
4. What could cause the investor to lose money even if the company grows?

**A compression of the P/E ratio (lower growth expectations lead to a lower P/E).**

1. During bull markets, P/Es **expand** as investors become more optimistic.
2. During bear markets, P/Es **contract** as investors become more pessimistic.
3. Remember, the P/E ratio is just an **opinion**. The market’s aggregate **opinion** about the future of a stock.