Price Earnings Ratio and PEG

Price Earnings Ratio and PEG

- The Price Earnings Ratio explains the financial relationship between the company's share price and its earnings per share
- How does the market value the earnings of the company?

Price Earnings Ratio and PEG

- It is most useful when comparing similar company or in time series analysis comparing the company's historic PE to its forecast PE
- As a ratio it enables comparison irrespective of the level of the share price or the size of the company

Price Earnings Ratio and PEG

- You should be aware of the difference between the trailing or historic PE and the forecast PE
- Trailing PE looks at previous earnings periods
- Forecast PE uses future estimates of earnings

Price Earnings Ratio and PEG

- The Earnings Per Share should be calculated using the weighted average number of shares over the period
- There may have been issues of shares during the year which make the starting and ending number different
- You may wish to use a fully diluted EPS number which assumes the conversion of all outstanding options and convertibles (and other dilutive securities such as warrants)

Price Earnings Ratio and PEG

- The PEG ratio or Price Earnings to Growth ratio takes this analysis a step further.

Price Earnings Ratio and PEG

- The PEG ratio is caculated by dividing the PE Ratio (Share Price/Earnings Per Share) by the EPS Growth Rate over the next few years
- The period of growth depends largely on your analysis but is typically 1-3 years

Price Earnings Ratio and PEG

- This helps to adjust for differences in growth between companies and enables us to evaluate the valuation of the market on a growth neutral basis
- This means that although high growth companies may appear to have high PE ratios, when adjusted for growth, their PEs may be in line with or lower than lower growth companies

Price Earnings Ratio and PEG

- Both the PE ratio and the PEG ratio are useful when conducting Comparable Company valuations
- You should always bear in mind that these ratios tell us nothing about cash flow, which is the ultimate arbiter of value creation

Price Earnings Ratio and PEG