Evaluating Stocks:
5 Financial Metrics You Must Know

1 P/E Ratio Price - Earnings Ratio

Price-Earnings (P/E) Ratio indicates the dollar amount an investor can expect to invest in a company in order to receive one dollar of that company's earnings, and it helps investors determine the market value of a stock compared to the company's earnings.

P/E Ratio = Price per Share / Earnings per Share

A high P/E Ratio could suggest:

- A stock's price is high relative to earnings or
- Investors are anticipating higher earnings growth in the future

A low P/E Ratio could suggest:

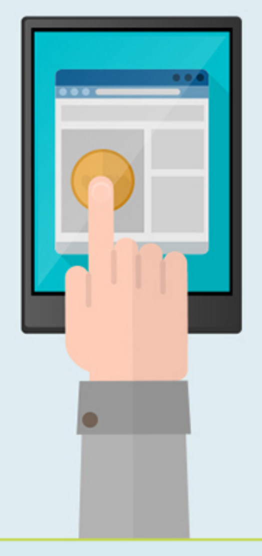
- A stock's price is low relative to earnings or
- The company is doing exceptionally well relative to its past trends

Note P/E Ratio is most useful when comparing companies in the same industry, and with similar growth expectations as PE that is considered very high in certain sectors can be considered very low in other sectors. For example, companies in technology and telecom sectors typically have higher PE Ratio than companies in the manufacturing or textile sectors.

2 P/B Ratio Price - To - Book Ratio

Measures whether a stock is over or undervalued by comparing the net assets of a company to the price of all outstanding shares. It is a good indication of what investors are willing to pay for each dollar of a company's assets.

P/B Ratio = Market Price per Share / Book Value per Share
Book value per share = (total assets - total liabilities) / number of shares outstanding



A higher P/B Ratio could suggest:

- The company has been earning a higher return on it's assets

A lower P/B Ratio could suggest:

- The stock is undervalued

Note P/B ratio can be useful for comparing companies within asset-intensive businesses but less useful for service-oriented businesses or those will lesser tangible assets. Investor should look at other complementary valuation metrics, when searching for undervalued stocks. One such useful companion metric is Return on Equity (see next section).

3 ROE Retun on Equity

Return On Equity (ROE) tells you how efficient is a company in using its shareholders' equity to generate profits. It represents how effective the company is, at turning the cash put into the business into greater gain and growth for the company and its shareholders.

Return on Equity = Net Income/Shareholder's Equity

All else equal, stocks with high **ROE** can be considered as the superior choice as they produce more profit from each dollar of equity.

- For high growth companies, you should expect a higher **ROE**
- Averaging **ROE** over the past five to 10 years can give you a better idea of the company's historical growth

Note While **ROE** is a handy measure of the management's effectiveness, it is not useful for ascertaining value of early-stage companies that do not produce profits.

4 Debt / Equity Ratio

The **Debt/Equity Ratio** is a debt ratio used to measure a company's financial leverage. It indicates how much debt a company is using to finance its assets relative to the value of shareholders' equity. The debt/equity ratio is also referred to as a risk or gearing ratio.

Debt/Equity Ratio = Total Liabilities / Shareholders' Equity

A low Debt-to-Equity Ratio could suggest:

- A lower amount of debt for financing versus shareholders' equity

A high Debt-to-Equity Ratio could suggest:

- The company derives more of their financing from debt relative to equity. Too much debt can pose a risk to a company if they don't have the earnings or cash flow to meet its debt obligations

Note As with the other ratios, the debt-to-equity can vary from industry to industry. It is important to note that some industries, with a lot of fixed assets such as automotive and construction industries, typically have larger ratios than companies in other industries.

5 Dividend Yield

Dividend refers to a share of a company's profits distributed to shareholders and therefore, dividend yield is known as the rate of dividend return. It is a financial ratio that indicates how much a company pays out in dividends each year relative to its share price. In the absence of capital gains, dividend yield is effectively the return on investment for a stock.

Dividend Yield = Dividend per Share/Earnings per Share

A higher dividend yield could suggest:

- The company is paying out more profits to it's shareholders

A lower dividend yield could suggest:

- The company is saving it's profit or
- The company may need the cash for future expansion plans

Note Companies in certain industries such as banks and utilities, often have good dividend yields even though they are not undervalued. And more so than often, companies trim or stop their dividend payments when going through difficult times.

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