Key Ratios Explained

P/E Ratio: A valuation ratio of a company's current share price compared to its per-share earnings. Calculated as: Market Value per Share / Earnings per Share (EPS) For example, if a company is currently trading at $43 a share and earnings over the last 12 months were $1.95 per share, the P/E ratio for the stock would be 22.05 ($43/$1.95). EPS is usually from the last four quarters (trailing P/E), but sometimes it can be taken from the estimates of earnings expected in the next four quarters (projected or forward P/E). A third variation uses the sum of the last two actual quarters and the estimates of the next two quarters. Also sometimes known as "price multiple" or "earnings multiple."

Earnings Per Share: The portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability. For example, assume that a company has a net income of $25 million. If the company pays out $1 million in preferred dividends and has 10 million shares for half of the year and 15 million shares for the other half, the EPS would be $1.92 (24/12.5). First, the $1 million is deducted from the net income to get $24 million, then a weighted average is taken to find the number of shares outstanding (0.5 x 10M+ 0.5 x 15M = 12.5M).

An important aspect of EPS that's often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies could generate the same EPS number, but one could do so with less equity (investment) - that company would be more efficient at using its capital to generate income and, all other things being equal, would be a "better" company. Investors also need to be aware of earnings manipulation that will affect the quality of the earnings number. It is important not to rely on any one financial measure, but to use it in conjunction with statement analysis and other measures.

Market Capitalization: The total dollar market value of all of a company's outstanding shares. Market capitalization is calculated by multiplying a company's shares outstanding by the current market price of one share. The investment community uses this figure to determine a company's size, as opposed to sales or total asset figures. Frequently referred to as "market cap."

Beta: A measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. Beta is used in the capital asset pricing model (CAPM), a model that calculates the expected return of an asset based on its beta and expected market returns. Also known as "beta coefficient." Beta is calculated using regression analysis, and you can think of beta as the tendency of a security's returns to respond to swings in the market. A beta of 1 indicates that the security's price will move with the market. A beta of less than 1 means that the security will be less volatile than the market. A beta of greater than 1 indicates that the security's price will be more volatile than the market. For example, if a stock's beta is 1.2, it's theoretically 20% more volatile than the market. Many utilities stocks have a beta of less than 1. Conversely, most high-tech, Nasdaq-based stocks have a beta of greater than 1, offering the possibility of a higher rate of return, but also posing more risk.