Forecasting High and Low PEs

Some Rules of Thumb
[SSG, part 4]

High PE

Seldom should it be more than 20-25

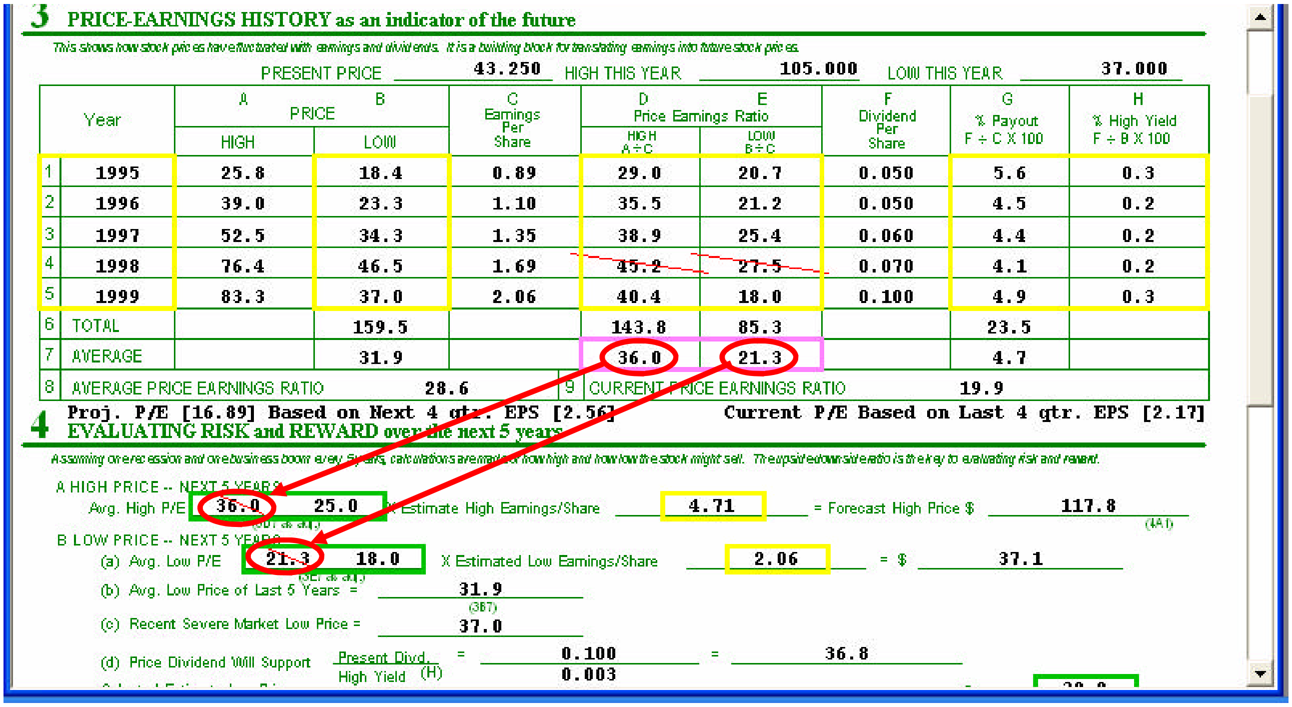
Seldom should it be higher than historical average

Another option is to make it no more than 1½ times forecast EPS growth rate

The forecasted growth rate earnings per share [from SSG graph, part 1] for the company on the graphic on the next page was 18% annually. Therefore, using the 3 rules above for forecasting high PE, the possible figures are

20—25 [first rule]
36 [second rule: historical high average]
27 [that is, EPS growth rate of 18% * 1½ = 27]

The way to not get overly optimistic is to select the most conservative answer [ie, first rule, 20-25]



3 PRICE-EARNINGS HISTORY as an indicator of the future

This shows how stock prices have fluctuated with earnings and dividends. It is a building block for translating earnings into future stock prices.

PRESENT PRICE 43.250 HIGH THIS YEAR 105.000 LOW THIS YEAR 37.000

	Year	A PRICE HIGH	B PRICE LOW	C Earnings Per Share	D Price Earnings Ratio HIGH A÷C	E Price Earnings Ratio LOW B÷C	F Dividend Per Share	G % Payout F ÷ C X 100	H % High Yield F ÷ B X 100
1	1995	25.8	18.4	0.89	29.0	20.7	0.050	5.6	0.3
2	1996	39.0	23.3	1.10	35.5	21.2	0.050	4.5	0.2
3	1997	52.5	34.3	1.35	38.9	25.4	0.060	4.4	0.2
4	1998	76.4	46.5	1.69	~~45.2~~	~~27.5~~	0.070	4.1	0.2
5	1999	83.3	37.0	2.06	40.4	18.0	0.100	4.9	0.3
6	TOTAL		159.5		143.8	85.3		23.5	
7	AVERAGE		31.9		36.0	21.3		4.7	

8 AVERAGE PRICE EARNINGS RATIO 28.6 9 CURRENT PRICE EARNINGS RATIO 19.9

Proj. P/E [16.89] Based on Next 4 qtr. EPS [2.56] Current P/E Based on Last 4 qtr. EPS [2.17]

4 EVALUATING RISK and REWARD over the next 5 years

Assuming one recession and one business boom every 5 years, calculations are made of how high and how low the stock might sell. The upside-downside ratio is the key to evaluating risk and reward.

A HIGH PRICE -- NEXT 5 YEARS

Avg. High P/E 36.0 25.0 (3D7 as adj.) X Estimate High Earnings/Share 4.71 = Forecast High Price $ 117.8 (4A1)

B LOW PRICE -- NEXT 5 YEARS

(a) Avg. Low P/E 21.3 18.0 (3E7 as adj.) X Estimated Low Earnings/Share 2.06 = $ 37.1

(b) Avg. Low Price of Last 5 Years = 31.9 (3B7)

(c) Recent Severe Market Low Price = 37.0

(d) Price Dividend Will Support Present Divd. / High Yield (H) = 0.100 / 0.003 = 36.8

[Red arrows and ovals above shows how Toolkit “defaults” the historical high and low PEs into parts 4a and 4b, respectively. These figures should not stand if <u>unrealistically high</u>, as in the case above.]

Low PE

Seldom should it be higher than the historical average.

Another option is to make it no more than the forecast EPS growth rate. [Note: 18 in this case, from SSG, part 1]

Therefore, using the 2 rules above for forecasting low PE, the possible figures are

21 [first rule—the historical figure]
18 [second rule—using the forecast EPS growth rate.

Again, select the lower figure, that is, 18.