The PEG Ratio

What the PEG Ratio Means

What it Measures

How Using the PEG Ratio Can Improve My Investing

American investor and philanthropist Peter Lynch is known for managing the Magellan Fund for 13 years, for his "buy what you know" investment phrase, and for creating the **price-to-earnings-growth (PEG) ratio**, which tells *how expensive a stock is compared to its growth potential*. Under his management, the Magellan Fund returned approximately 29% per year and outperformed some of the most well-known indexes.

WHAT is the PEG Ratio

- The PEG ratio is a metric used to analyze stocks. It divides a stock’s price to earnings ratio (PE) by the growth ***rate*** of its earnings per share.
  - Used to better understand that stock’s *future* value.
  - The growth rate period used to calculate a PEG ratio is typically calculated over a period of one to three years.
- The Price/Earnings-To-Growth (PEG) ratio is a financial metric that helps investors better understand stocks they're considering investing in.

Sources: Seeking Alpha Web Site and Better Investing SSGPlus

Written By: Amanda Reaume
Updated: May 18, 2022
https://seekingalpha.com

PE vs PEG

- Price-to-Earnings Ratio (PE)--simply the price of a stock divided by the company’s annual earnings per share.
- Many investors look at a company's price-to-earnings ratio (P/E ratio) to determine if that company is a good investment.
- The SSG, and thus, ”we” use the PE in section 4 to project the 5-year future High and Low stock price.
  - ***but*** a company's P/E ratio might be hiding the fact that the stock is overpriced or underpriced without considering **future** earnings **growth**.

PE: *Caution*

- However, if two companies have the same PE Ratio but one company has experienced a 40% growth in earnings over the last three years while the other only experienced a 10% growth in earnings, the stock that is growing faster is likely underpriced and could be the better company to invest in.

For example, if a stock earns $5 per share and has a stock price of $20 per share then the company's P/E ratio is 4. That means that its share price is 4x its earnings.

PEG Calculation

- A PEG ratio is calculated by taking that P/E ratio and dividing it by a company's growth rate over a specific period of time. Example, if the stock mentioned above grew 20% in the last year, its PEG ratio would be 0.2. (4 PE/20 GR = .2)

Both metrics tell investors something about a company, but the PEG ratio includes data that the P/E ratio leaves out, helping give an investor a better idea of a company's **value** in ***relation*** to its share price.

PEG from the SSG Plus*

PEG: (used in PERT report, SSGPlus and SCGPlus)
Projected PE / Forecast EPS Growth Rate
Projected PE--Current Stock Price/Estimated EPS Next 12 Months
Forecast EPS Growth Rate--The average growth rate is calculated by determining the least squares regression line of best fit using the natural log (LN) of the company data. The growth rate is the slope of that line. For data points that are less than or equal to zero, we substitute the very small number of .001 in the calculation.

*Source: BI web page from any stock SSG, “SSG Calculation Reference.”

Calculating PE and PEG Ratios

Fortunately, the SSG Plus has calculated the PEG Ratio for us.

BetterInvesting SSG PLUS

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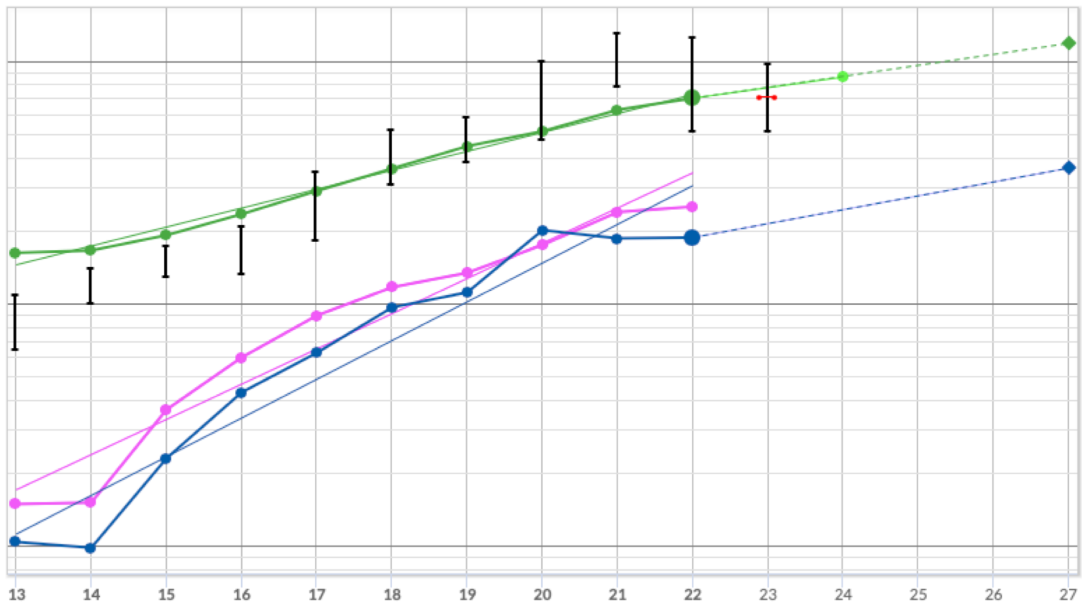
Analyze Growth and Quality | Valuation and Return | Quarterly Data | Ratios | Audit | Sentiment | Notes: 5

Company: Adobe (ADBE) Study Name: ADBE 2/8/2023

Quick Navigation



PROJECTION STARTING POINT

Annual | Quarter | Trend

RECENT QUARTERLY FIGURES

FY2022 Quarter Ending (11/22)

	Sales	EPS
Latest Quarter	4,525	2.53
Year Ago Quarter	4,110	2.57
Percentage Change	10.1%	-1.6%

ANALYST CONSENSUS ESTIMATES

Sales 2 Year Estimate: 10.6%
EPS Long Term Estimate: 14.1%

LEGEND

Sales
Pre-Tax Profit
Prices Hi/Lo
EPS
Book Value/Share
Free Cash Flow/Share
Dividend
Total Debt
Net Income
Shares Outstanding
Sales Detailed Estimates
EPS Detailed Estimates

Reset Chart | Compare Peers

Fundamental Company Data

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Growth (%)	Forecast (%)	5 Yr Est
Historical Sales ($M)	4,055	4,147	4,796	5,854	7,302	9,030	11,171	12,868	15,785	17,606	19.7%	11	29,667
Historical EPS ($)	0.56	0.53	1.24	2.32	3.38	5.20	6.00	10.83	10.02	10.10	44.5%	14.1	19.53
Pre-Tax Profit ($M)	356	361	874	1,435	2,138	2,794	3,205	4,176	5,705	6,008	39.8%		

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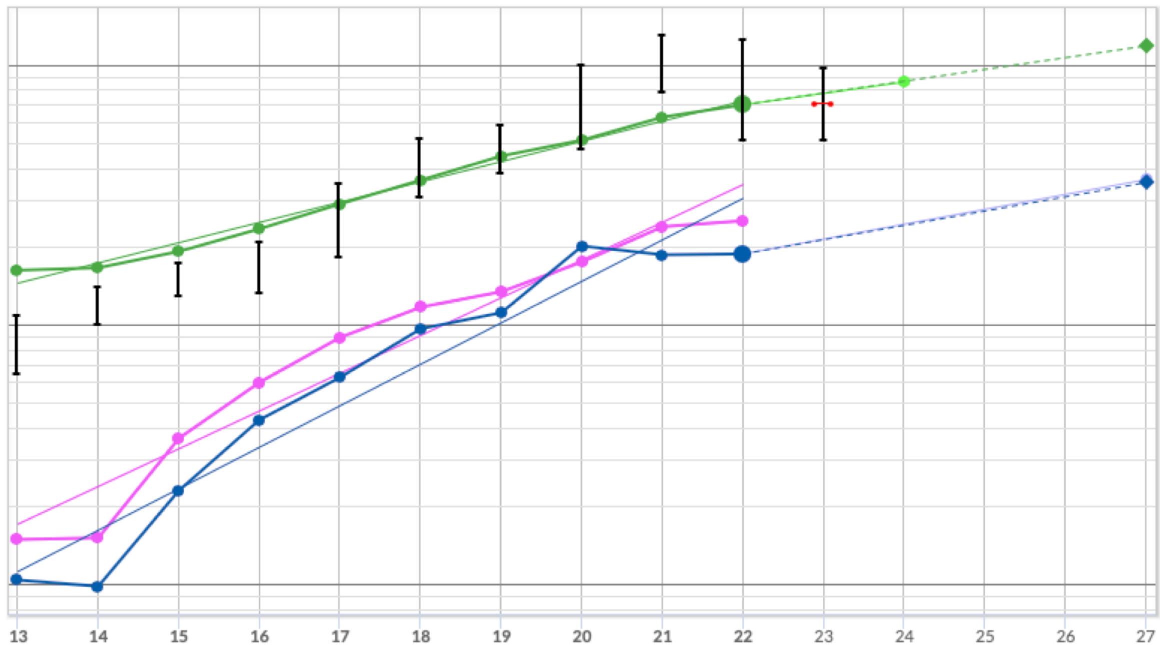

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- Sales
- Pre-Tax Profit
- Prices Hi/Lo
- EPS
- Book Value/Share
- Free Cash Flow/Share
- Dividend
- Total Debt
- Net Income
- Shares Outstanding
- Sales Detailed Estimates
- EPS Detailed Estimates

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Valuation Ratios

RELATIVE VALUE ?

Current P/E: **38.0** / Average 5 Year P/E: **45.1** X 100 = **84.3%**

PROJECTED RELATIVE VALUE ?

Projected P/E: **33.5** / Forecast Average P/E: **41.0** X 100 = **81.7%**

PEG RATIO ?

Projected P/E: **33.5** / Forecast EPS Growth Rate: **13.5%** = **2.5**

View Calculation Reference

Projected PE: Current Stock Price/Est EPS Next 12 Months

ADBE vs Peers

Symb	Price	Proj PE	Proj Gr Rate	PEG
MSFT	$292	28.8	12.6%	2.3
ORCL	$ 96	29.0	9.1%	3.2
VMW	$122	35.8	10.7%	3.3
ADBE	$383	33.5	13.5%	2.5

Benefits of the PEG RATIO

Pros of PEG

- **Allows investors to better compare stocks:** PEG ratios help investors compare stocks that are growing at different rates.
- **Low PEG ratios can indicate future price movement:** This can potentially indicate a higher stock price in the future since the security's growth hasn't yet been priced into its share price.
- **Dividend growth:** Companies with low PEG ratios are often more likely to grow their dividends in the future.
- **More meaningful than P/E ratio:** A PEG ratio gives you a better understanding of a company's potential future value.

Limitations of the PEG Ratio

- **Earnings might not continue to grow at the same rate:** The PEG ratio assumes that earnings growth will remain constant.
- **Growing companies can be more volatile:** Companies that are growing rapidly are more likely to miss earnings or stumble than established companies that grow at a slower rate.
- **Does not replace a deeper analysis:** Investors should still do a comprehensive analysis of a company's financial statements, leadership, and projections.