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HAVE A GOOD CASE?
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Smart Money

PRICE-EARNINGS RATIOS: WHAT MAY NOT MEET THE EYE

It looks simple. Divide a company's current stock price by its earnings per share, and you've got its price-earnings ratio, a time-honored measure of investment value. But while calculating the p-e is easy, using it effectively can get tricky.

Every company actually has several p-e ratios, or multiples, which can vary significantly, even with a stable drug company such as Merck (table). Your daily paper reports the trailing p-e, based on per-share earnings for the past 12 months. But smart investors study the forward p-e, based on projected earnings for the current year—and even the estimated p-e for next year, if they're evaluating long-term growth potential.

REVERSED RULE. Often, brokers recommend a stock with a low p-e, implying it's a bargain buy. But you have to

ask, "low in relation to what?" One important measure is a firm's industry group. Kenner Parker Toys, for instance, has a forward p-e of 19.6, says Value Line analyst Mary Sunderland. That's close to the forward

ONE COMPANY, THREE P-E'S

	Merck & Co. earnings per share	Price- earnings ratio*
CALENDAR 1986	\$4.85	37
TRAILING 12 MONTHS	5.69	32
1987 ESTIMATE	6.12	29

*Based on share price of \$180
DATA: ZACKS INVESTMENT RESEARCH INC.

p-e of 17.5 for the Standard & Poor's 500. But compared with the average toy industry multiple of 12, Kenner looks expensive right now.

For companies in cyclical industries such as autos or insurance, the usual "look for a low multiple" rule is

reversed, explains Arnold Kaufman of S&P. Investors buy when earnings are low, which usually makes for a high p-e. By investing in a down period, you stand to benefit when the upswing comes. Conversely, a low p-e hints the company is at the cycle's peak, ready for a fall.

Traditionally, a high multiple indicates a fast-growing—and risky—stock. But it can be inconclusive for small startups that lack a consistent earnings history. "Most speculative issues don't trade on multiples but on concepts—a new drug, a desktop publisher—and their enormous growth prospects," notes David Walke of the Morgen-Walke investor relations firm.

Multiples are also misleading when companies suffer setbacks. In 1986 semiconductor makers looked bad because "they were losing

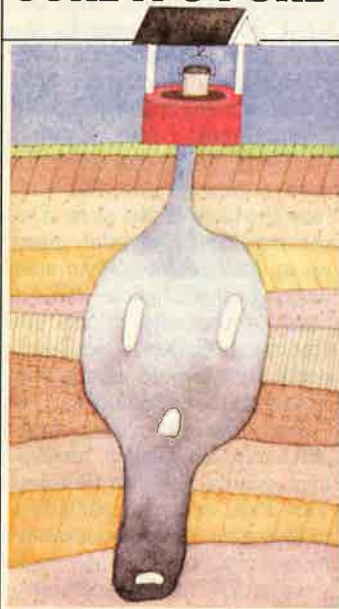
money, even though their earnings potential was great," says Raymond Frankel of Technological Investors Management. A better way to look at depressed firms: Compare price-sales ratios (stock price divided by revenue per share).

VOLATILITY. The p-e may be less relevant with companies that are valued chiefly by their assets. Among them: real estate and oil companies and media companies whose main asset is dominance in a local market. Such outfits are often evaluated in terms of cash flow instead of p-e.

Critics play down the p-e's usefulness in today's volatile market. But p-e's are still valid investment tools, says Steven Einhorn, co-chairman of Goldman Sachs' investment policy committee—provided you use them as "the starting point—never the end point." *Troy Segal*

Health

WELL WATER: HOW TO BE SURE IT'S PURE



When you turn on the tap at your rural retreat, the well water that fills your glass is crystal clear—but that's no guarantee it's free of harmful contaminants. Finding out requires a scientific test. And don't rely on one from a company that promotes its own water-treatment products, says Peter Jacobson, of Woodward-Clyde Consultants in Plymouth Meeting, Pa.

Instead, ask the local health department for a list of suspect contaminants in your area. Officials there may also be able to suggest commercial testing labs. And they can probably help interpret the report you get back, says Kenneth Markussen, of New York State's Health Dept.

The health department or a lab can test for harmful bacteria for about \$10 to \$20. But fees can shoot up like a geyser if someone comes to take samples for hard-to-find toxic chemicals. A comprehensive

test for about 80 common pollutants on the Environmental Protection Agency's list can run \$1,000 or more.

SEND A SAMPLE. You can save by ordering a kit that permits you to draw your own samples to mail in for analysis. Labs that check for a wide range of contaminants, for about \$100, include National Testing, in Ohio (800 458-3330); Suburban Water Testing, in Pennsylvania (800 433-

6595); and Water Test, in New Hampshire (800 426-8378). Keeping the samples pure, though, and rushing them to the lab by overnight express can present problems.

If yours is among the 13 million homes that rely on well water, check annually for coliform bacteria and nitrates, says Benjamin Tamplin, of California's Health Dept. And order a more extensive test every five years. *S.W.*

Worth Noting

■ **COOL IT.** Hate leaving your room air conditioners on all day to have the place comfortable when you get home? X-10 (USA) Inc. (800 526-0027) sells \$15 and \$25 plug-in sockets for each 110- or 220-volt unit. A \$40 controller lets you phone home anytime to turn the air conditioner on or off.

■ **MANAGING MONEY.** With as little as \$100,000 to invest, you may not attract a professional money manager. But E. F. Hutton will study your objectives and team you with 1 of 20 "Hutton select managers," whose clients normally have at least \$500,000. But you pay handsomely: 3% of portfolio value.

■ **TERRORISM TIP.** To look less like an American when you're abroad, carry a newspaper in the local language—even if you can't read it. And if you're a smoker, use local cigarettes.