



THE MOTLEY FOOL®

To Educate, Amuse & Enrich

Fool's School

The Earnings Yield

Looking at a company's price-to-earnings ratio, or "P/E," to get an idea of its relative price, can be useful. Calculating the P/E's inverse — the "earnings yield" — can be enlightening, too.

As an example, to calculate the P/E of Home Surgery Kits Inc. (ticker: OUCHH), you simply divide the current stock price by the annual earnings per share (EPS). If its current annual EPS is \$2 and the stock is trading for \$80 per share, the P/E is 80 divided by \$2, or 40. While 40 seems steep, it's not meaningful until you compare it with the P/E ratios of industry peers and consider the firm's health, competitive position and growth prospects.

To calculate Home Surgery Kits' earnings yield, just reverse the P/E ratio, dividing the annual EPS by the current stock price. \$2 divided by \$80 equals 0.025, or 2.5 percent. Compared to risk-free Treasury bond rates of roughly 3 to 4 percent, this doesn't seem like a bargain. But remember: Whereas bond rates are

fixed, earnings typically grow. If Home Surgery is expected to increase earnings by 10 percent per year, in 10 years its EPS should grow to \$5.19. If we bought our shares at \$80, our effective earnings yield would become 6.5 percent, considerably better (\$5.19 divided by \$80 is 0.065).

It can be instructive to see how long it takes for the growing earnings yield to pass the current 30-year bond rate, or your target rate. If your desired rate of return for your invested dollars is 12 percent, it will take about 18 years of earnings growth before the earnings yield of Home Surgery beats that target — if earnings actually grow at the estimated pace. You can probably find other investments that will get you there more quickly. With riskier companies, you might look for them to pass your target rate sooner rather than later.

The earnings yield can help you think more clearly about your expectations for investments. But remember to always examine many measures of a company, and not just one or two. ■

My Smartest Investment

Worth Hanging On

Years ago I bought 400 shares of Telefonos de Mexico for \$1 per share on the recommendation of John Templeton. It was soon worth less than a dime per share and wasn't worth selling, so I hung on. In a retooling of shares, I ended up with 140. As Mexico's economy improved, so did the company. My shares are now worth about \$13,000, and I've received far more than my original investment in dividends alone. It just took a little patience.

— Robert P., Landis, N.C.

The Fool Responds: It's been nearly a decade since you sent us this story — but it contains a lesson that bears repeating. And if you're still hanging on to your shares, they've more than doubled since then. Patience is indeed a critical quality of great investors. As Sir John himself urged: "Invest — don't trade or speculate. The stock market is not a casino, but if you move in and out of stocks every time they move a point or two, or if you continually sell short, or deal only in options or trade in futures, the market will be your casino. And, like most gamblers, you may lose eventually — or frequently. ■



Do you have an embarrassing lesson learned the hard way? Boil it down to 100 words (or less) and send it to *The Motley Fool* c/o *My Dumbest Investment*. Got one that worked? Submit to *My Smartest Investment*. If we print yours, you'll win a Fool's cap!

Last week's trivia answer

I was founded in 1868 on a salt dome island in Louisiana by a guy who made a sauce out of peppers from Mexico or Central America and French wine vinegar. Legend has it that he first packaged the product in used perfume bottles. In 1892, he founded a bird colony on the island to protect egrets that were being killed for their decorative feathers. He soon added plant life, and today his famed Jungle Gardens and Bird City attract visitors from all over the world. Each of my 2-ounce red bottles contains at least 720 drops. Who am I? ■

(Answer: McIlhenny Co.)



Write to Us! Send questions for *Ask the Fool*, *Dumbest (or Smartest) Investments* (up to 100 words), and your *Trivia* entries to Fool@fool.com or via regular mail c/o this newspaper, attn: *The Motley Fool*. Sorry, we can't provide individual financial advice.

What Is This Thing Called The Motley Fool?

Remember Shakespeare?

Remember "As You Like It"?

In Elizabethan days, Fools were the only people who could get away with telling the truth to the King or Queen.

The *Motley Fool* tells the truth about investing, and hopes you'll laugh all the way to the bank.

Ask the Fool

The Long and Short of Pair Trades

Q What's a "pair trade"?

— R.K., Fairfield, Calif.

A It's the practice of making two related trades at the same time. One is a "long" position (i.e., buying a stock with the expectation that it will increase in value) and the other a "short" position (where you borrow and sell a stock you expect will fall, planning to buy it back later at a lower price). The two securities will have a strong relation to each other.

For example, when the price of oil recently began falling, some people expected gold to rise. If so, they may have done some pair trading, buying gold-related securities and shorting oil-related ones.

Q What's a company's "burn rate"?

— W.G., Decatur, Ill.

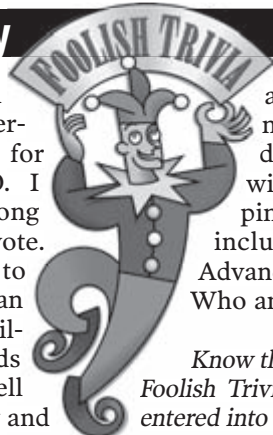
A It refers to how quickly the company is burning through cash. This isn't often an issue for large, established companies, but with small and quickly growing ones, a glance at the burn rate can be valuable. The number to examine is free cash flow, which is income from operations, less capital expenditures.

For example, imagine that in its most recent quarterly report, the Meteorite Insurance Co. (ticker: HEDSUP) reported negative \$20 million in free cash flow, as its cash balance fell to \$80 million from \$100 million in the previous quarter. It's not unusual for firms to lose money in their early years, but it's also what puts many of them out of business. In HEDSUP's case, at its current burn rate, it'll use up its cash in just a few quarters. To stay alive, it will have to reduce spending (possibly resulting in slower growth) or find some more money (perhaps taking on debt or issuing additional stock, diluting value for existing shareholders). ■

Got a question for the Fool? Send it in — see *Write to Us*.

Name That Company

In 1886, I was founded by a man as the California Perfume Co. I'm "the company for women," with a female CEO. I offered women an income long before they were allowed to vote. In 1939 I changed my name to the home of a famous European playwright. My more than 5 million sales reps distribute hundreds of millions of catalogs and sell beauty products, fashion jewelry and



apparel in more than 100 nations. I'm the largest direct seller in the world, with annual revenues topping \$10 billion. My brands include Anew, Skin-so-Soft, Advance Techniques and Mark. Who am I? ■

Know the answer? Send it to us with *Foolish Trivia* on the top and you'll be entered into a drawing for a nifty prize!

The Motley Fool Take

Change Comes to Wal-Mart

Change is in the air these days, and Wal-Mart (NYSE: WMT) recently announced that CEO H. Lee Scott, who has led the company for almost nine years, plans to retire. With Wal-Mart firing on all cylinders lately, Scott is leaving while it's all on a roll.

He departs on Feb. 1, 2009, when the company's fiscal year ends. His replacement, Mike Duke, currently CEO of Wal-Mart's international segment, is coming in at an interesting time. Although Wal-Mart has been a bright spot in these tough economic times, it recently indicated that it may not be bulletproof — or recession-proof — as

consumers struggle with their budgets.

Meanwhile, although it's been much easier to lure customers focused on cost-cutting these days, one can only hope Wal-Mart won't lose sight of the importance of protecting its brand while not seeming to do its business in a thugish manner, which has often been a problem in the past. Plus, with the new Democratic administration coming in, an increase in the power and influence of unions could present a challenge for Wal-Mart.

If Wal-Mart can continue to make good changes (it recently announced plans to use wind power to power some stores, for example), any market share it steals during the recession might stick. ■

BUSINESS BRIEFS

Commercial real estate

► **Pepitone Properties Corp.** announced the following transactions:

Dr. Peter Curcione of Kagan, Jugan & Associates leased 10,000 square feet for comprehensive orthopedic care at Sunshine Professional Suite, 3400 Lee Blvd., Lehigh Acres, from Sunshine Professional Suites. Tom Pepitone, of Pepitone Properties Corp. represented the landlord and the tenant.

► **Aqua Pool & Spa Supply** leased 1,600 square feet of retail space at the Bella Rosa Shops, 8911 Daniels Parkway, Fort Myers, from Salrose Dreams. Tom Pepitone, of Pepitone Properties Corp. represented the landlord and the tenant.

► **Woodyard & Associates, LLC** announced the following transactions: Shelley Capaldi, d/b/a Liberty Tax Services, leased office space for 16 months from Pinebrook Pine, LLC, 12995 S. Cleveland Ave, Suite 137, Fort Myers. Steve Wood and Todd Holman of Woodyard & Associates, LLC negotiated the transaction.

► **Red Ink Tattoo** leased 1,225 square feet of space for one year from Metro Parkway Realty Associates, LLC, 12951 Metro Pkwy, Unit 5, Fort Myers. Alex Wright, CCIM of Woodyard & Associates, LLC represented the lessor and Theresa Blauch-Mitchell of Mitchell Commercial Realty Group represented the lessee.

► **The Law Office of J. Patrick Buckley III, P.A.** leased 1,444 square

feet of office space for two years from Jack and Virginia Shea, 1342 Colonial Blvd., Suite H60, Fort Myers. Steve Wood of Woodyard & Associates, LLC negotiated the transaction.

► **Internet Services Group of Florida, LLC** leased 1,166 square feet of office space for two years from NRP Leasing, 12771 World Plaza Lane, Bldg 87, Suite 2, Fort Myers. Steve Wood of Woodyard & Associates, LLC negotiated the transaction.

► **John Ruff & Bryan Smith** leased office space for two years from GSC Office, LLC, 8981 Daniels Center Dr, Unit 205W, Fort Myers. Scott Roberston of Cushman & Wakefield of Florida, Inc. represented the lessor and Steve Wood of Woodyard & Associates, LLC represented the lessee.

► **Laurel & Robert Crawford, d/b/a**

Laurel's Custom Upholstery and Interiors leased 1,032 square feet of space for one year from Four J Real Estate Holdings, LLC, located at 2126 Andrea Lane, Unit 2, Fort Myers. Honora' Jacobus of Woodyard & Associates, LLC negotiated the transaction.

► **Dale Perrigo, d/b/a Florida Coast Realty Group**, leased office space for one year from Pinebrook Pine, LLC, located at 12995 S. Cleveland Ave, PBS 45, Fort Myers. Steve Wood of Woodyard & Associates, LLC negotiated the transaction.

► **Plaza Shoe Repair, Inc.** renewed its lease for months from Pinebrook Pine, LLC, located at 12995 S. Cleveland Ave, Suite 131, Fort Myers. Steve Wood & Todd Holman of Woodyard & Associates, LLC negotiated the transaction. ■