



## EARNINGS-PER-SHARE (EPS): PART 1

There are lots of ways to measure the value of a company and understanding them is the key to understanding how market traders make their buying and selling decisions. One of these valuation methods is earnings-per-share, usually referred to just as EPS.

The basics of EPS are easy to understand:

To calculate the earnings-per-share (EPS) for a company just divide the company's net profit by the number of shares available to the market (shares outstanding).

*Example:* A company has a net profit for the year 2019 of \$6 billion. During 2019 the average number of shares the company had outstanding was 4 billion, giving an EPS of \$1.50:  $\$6 \text{ billion} \div 4 \text{ billion} = \$1.50$

So, EPS tells you how much profit a company makes per share.

## IS IT REALLY THAT SIMPLE?

Like many things in the world of finance, although EPS seems really simple at first glance there are a number of 'gotchas' that you need to be aware of. We'll look at some of these in more detail in later articles but this is what they boil down to:

- **The number of shares outstanding can change.** Companies can issue more shares, buy up existing shares, carry out splits, etc. and investors can exercise stock options – all of these change the number of shares outstanding. You need to take account of this when calculating EPS for a given period.
- **There are different ways to measure net profit.** For example, it's normal to subtract the total amount of 'preferred dividends' from the company's net income when calculating EPS. Companies also usually exclude 'extraordinary items' from their net profit when calculating EPS. These might be extraordinary profits (for example from selling off assets) or extraordinary losses (for example paying out compensation for an oil spill).
- **Different companies operate differently, especially in different sectors.** This means that comparing EPS across companies is not always meaningful. For example, at time of writing Uber has never made a profit yet plenty of people think it's a good investment.

## LEARN MORE

[Read more about earnings-per-share on Investopedia](#) (shortlink [bit.ly/333ORNA](https://bit.ly/333ORNA)).

## CHECK YOUR UNDERSTANDING

1. Apple reported a quarterly EPS of \$2.58 for Q2 2020. For the same period they reported 4.35 billion shares outstanding. Therefore what is the adjusted net profit used to calculate the EPS?
  - a. \$11.223 billion
  - b. \$22.331 billion
  - c. \$15.165 billion
  
2. Which of these would you expect to not include when calculating net profit for the purposes of calculating basic EPS?
  - a. Costs associated with divesting part of the company
  - b. Profits from selling a product that the company recently discontinued
  - c. Costs associated with developing the latest version of a product

*Answers at the end of this document*

## WHAT IS SI:REDUX?

SI:REDUX is a free online stock market trading game designed to be used as a learning aid by teachers of students aged around 13-19 years old. The game is open to anyone, but is primarily aimed at teachers of secondary school pupils in the UK to use as a replacement for the Student Investor Challenge which is sadly not going ahead in 2020/21.

SI:REDUX will launch in September 2020. Please register your interest on the website at [siredux.trade](https://siredux.trade) to keep informed.

## The Answers!

1. **Correct Answer: \$11.223 billion**

As  $EPS = \text{net profit} / \text{number of shares}$  the net profit in this case is the EPS (\$2.58) multiplied by the number of shares outstanding (4.35 billion)

2. **Correct Answer: Costs associated with divesting part of the company**

Extraordinary costs/profits are not normally included when calculating basic EPS. This normally means one-off costs/profits.