EARNINGS PER SHARE (EPS)

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EARNINGS PER SHARE (EPS)

EPS or Earnings Per Share is the portion of the company's distributable profit which is allocated to each outstanding equity share.

A company’s EPS is calculated as:

$$= \frac{\text{Net Profit for a period}}{\text{Number of Shares}}$$

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That means, if Company ABC has posted a net profit of Rs. 1,000 and it has a total of 100 shares, its EPS will be Rs. 10 per share.

EARNINGS PER SHARE (EPS)

So what are the different types of Earnings?

- **Earnings can be sub-divided further according to the time period involved.**
- **Earnings can be assessed by**
  - **Trailing - Prior earnings**
  - **Current - Recent earnings**
  - **Forward - Projected future earnings**

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Why EPS?

EARNINGS PER SHARE (EPS)

- **EPS is the amount of money each share would receive if all the profits were distributed to the outstanding shares at the end of the year.**
- **EPS helps compare two companies. Higher EPS is better than a lower EPS because this means the company is more profitable and has more profits to distribute to its shareholders.**
- **EPS is also a key driver of share prices.**
- **It is also used as the denominator in the frequently cited P/E ratio.**

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EARNINGS PER SHARE (EPS)

Let's consider a simple example:

Company X and Y have earned a profit of Rs. 150 each. However, Company X has 75 shares outstanding and Company Y has 100 shares outstanding, which one would you prefer?

Your answer lies in the EPS figure. Company X has an EPS of 2 (150/75) whereas company Y has an EPS of just 1.5 (150/100). So you prefer the company X that pays you more profit per share than Company Y.

When does EPS increase?

Earnings Per Share (EPS)

- **An increase in a company's EPS doesn't necessarily mean that the profitability has gone up; profits can also remain flat or even fall.**
- **It could be because of changes in capital structure like a buy-back programme or merger & acquisition, due to which the number of shares has reduced.**
- **All this would result in an increase in EPS.**

Suppose, the profit of Company ABC reduces to Rs. 900 and total number of shares reduce to Rs. 85 due to its share buy-back. Here, the EPS would go up to Rs. 10.59 per share. (As compared to earlier example on Slide 4).

When does EPS go down?

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Earnings Per Share (EPS)

- **Just like the increase in EPS, a dip doesn't mean that the profitability of a company has gone down.**
- **A public offer or an activity to raise fresh capital could decrease the EPS. Even share splits can reduce the EPS.**

Let's assume that the profit of Company ABC goes up to Rs. 1,100 and it raised its total number of shares to 120. This would mean the EPS would go down to Rs. 9.17 per share, while the company remains profitable.

How to use EPS?

Earnings Per Share (EPS)

- **Remember, EPS should not be the only measure to influence your decision.**
- **If you own a stock whose EPS has fallen, you should not be in a hurry to exit.**
- **When deciding whether to stay invested or not in a stock that has witnessed a fall in EPS, you should identify the reason behind the decline.**

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EARNINGS PER SHARE (EPS)

Hope you have understood the concept of ‘Earnings Per Share’.

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Thinking of Investment

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