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# **Earnings per Share (EPS)**

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## Lecture -1

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## Topic covered

EPS : Introduction

Basic EPS

Basic EPS Factors : Full Market Issue

Basic EPS Factors : Bonus Issue

Basic EPS Factors : Right Issue

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## EPS : Introduction

Earnings per share (EPS) is widely regarded as the most important indicator of a company's performance. It is important that users of the financial statements:

- are able to compare the EPS of different entities; and
- are able to compare the EPS of the same entity in different accounting periods.

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## EPS : Introduction

IAS 33 Earnings per Share achieves comparability by:

- ✓ defining earnings
- ✓ prescribing methods for determining the number of shares to be included in the calculation of EPS
- ✓ requiring standard presentation and disclosures.

IAS 33 applies to entities whose ordinary shares are publicly traded. Publicly traded entities which present both parent and consolidated financial statements are only required to present EPS based on the consolidated figures.

## Basic EPS

The basic EPS calculation is simply:

$$\text{Earnings} / \text{Shares}$$

This should be expressed as cents per share to 1 decimal place.

- Earnings: group profit after tax, less non-controlling interests (see group chapters) and irredeemable preference share dividends.
- Shares: weighted average number of ordinary shares in issue during the period.

## Basic EPS Factors : Full Market Issue

cash generated so weighted average table required.

Earnings should be apportioned over the weighted average equity share capital (i.e. taking account of the date any new shares are issued during the year).

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## Basic EPS Factors : Bonus Issue

A bonus issue (or capitalisation issue or scrip issue):

- does not provide additional resources to the issuer
- means that the shareholder owns the same proportion of the business before and after the issue.

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## Basic EPS Factors : Bonus Issue

In the calculation of EPS:

- in the current year, the bonus shares are deemed to have been issued at the start of the year
- comparative figures are restated to allow for the proportional increase in share capital caused by the bonus issue. Doing this treats the bonus issue as if it had always been in existence.

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## Basic EPS Factors: Right Issue

Rights issues present special problems:

- they contribute additional resources
- they are normally priced below full market price.

Therefore they combine the characteristics of issues at full market price and bonus issues.

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## Basic EPS Factors : Right Issue

Since Right Issue combine the characteristics of issues at full market price and bonus issues, therefore, the calculation of shares in issue reflects this:

1. Adjust for bonus element in rights issue, by multiplying capital in issue before the rights issue by the following fraction:

*Market price before issue / Theoretical ex rights price*

2. Calculate the weighted average capital in the issue as above.



## Basic EPS Factors : Right Issue

Calculating EPS in case of rights issue can be done as follows:

### **Step 1 – Calculate theoretical ex-rights price (TERP)**

Start with the number of shares previously held by an individual at their market price. Then add in the number of new shares purchased at the rights price. You can then find the TERP by dividing the total value of these shares by the number held.

### **Step 2 – Bonus fraction**

*Market price before issue / Theoretical ex rights price*

## Basic EPS Factors : Right Issue

### Step 3 – Weighted average number of shares

Draw up the usual table to calculate the weighted average number of shares. When doing this, the bonus fraction would be applied from the start of the year up to the date of the rights issue, but not afterwards.

### Step 4 – Earnings per share (EPS)

You can now calculate earnings per share in the usual way:

$$\textit{Profit after tax / Weighted average number of shares}$$

## References

Financial Reporting (Fr) - Study Text, The Association Of Chartered Certified Accountants (ACCA). Kaplan Publishing

<https://www.iasplus.com/en/standards/ias/ias33>

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**Thank You**

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