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CIA Study Note

Earnings Per Share

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Table of contents

Table of contents.....2
Definition3
Interpretation3

Definition

Earnings per share, or EPS, is an important financial measure that indicates the profitability of a company. It is calculated by dividing the company's net income with its total number of outstanding shares. It is a tool that market participants use frequently to gauge the profitability of a company before buying its shares.

Interpretation

EPS is the portion of a company's profit that is allocated to every individual share of the stock. It is a term that is of much importance to investors and people who trade in the stock market. The higher the EPS of a company, the better its profitability. While calculating the EPS, it is advisable to use the weighted ratio, as the number of shares outstanding can change over time.

EPS can be calculated in two ways:

- 1) EPS: $(\text{Net income after tax}) / (\text{Total number of outstanding shares})$
- 2) Weighted EPS: $(\text{Net income after tax} - \text{total dividends}) / (\text{Total number of outstanding shares})$

A more diluted version of the ratio also includes convertible shares as well as warrants under outstanding shares. It is considered to be a more expanded version of the basic EPS ratio.

For an investor who is primarily interested in a steady source of income, the EPS ratio can tell them the room a company has for increasing its existing dividend. Although, EPS is a very important and crucial tool for investors, it should not be looked at in isolation. The EPS of a company should always be considered in relation to other companies in order to make a more informed and prudent investment decision.



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