



ACCOUNTING

The language of the business world

ACC 1701X

Accounting for Decision Makers

Lecturer: Dr. Hanny Kusnadi

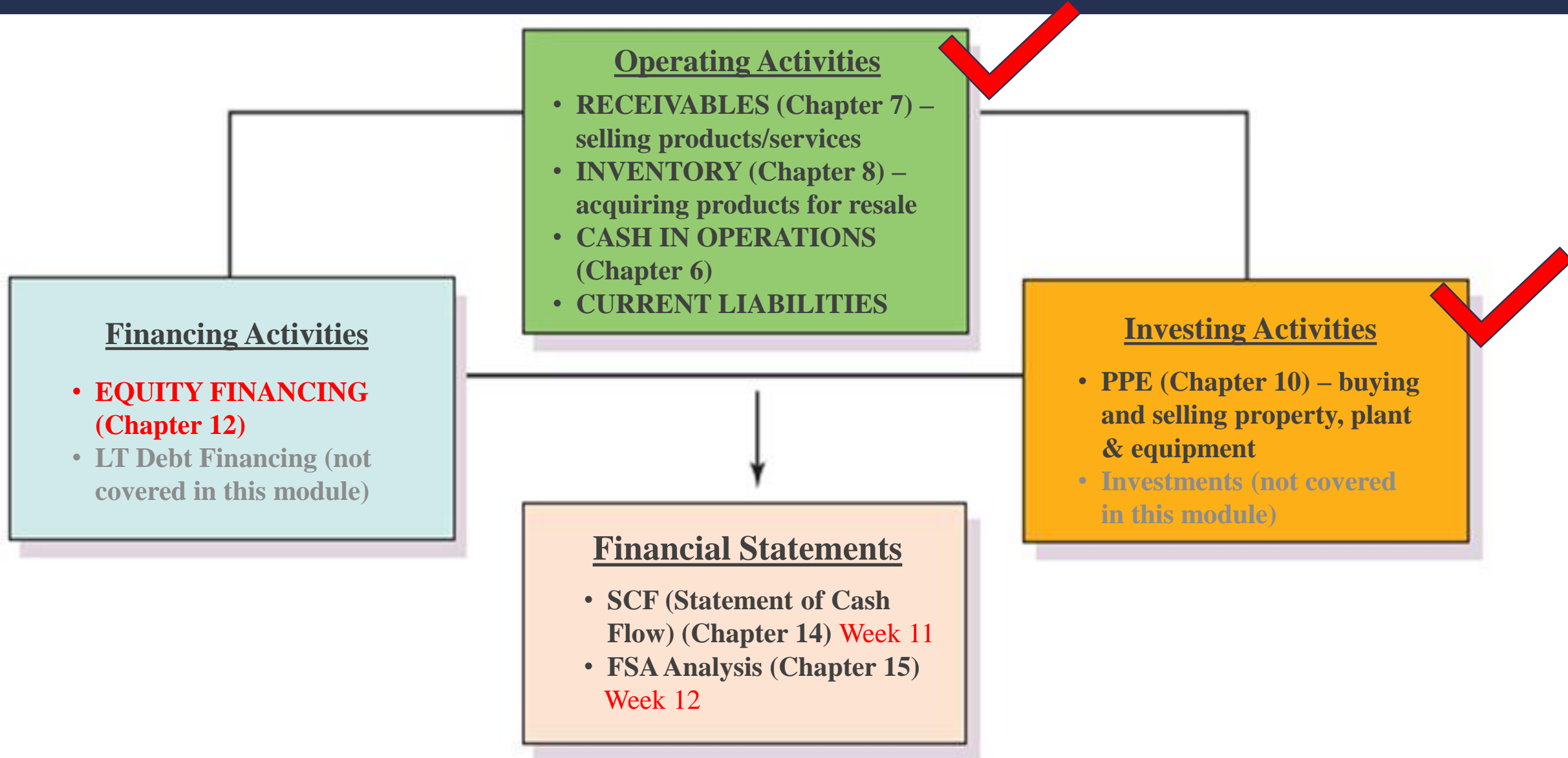
Prior Lecture 09 Refresher

- PPE (Property, Plant & Equipment)
 - Depreciation methods: Straight-line, Units-of-production, Declining-balance
 - Recording PPE transactions:
 - Acquisition - at cost + necessary expenditures to get asset ready for its intended use.
 - Changes in estimates – recalculate depreciation going forward
 - Capital expenditures – capitalize expenditures that extends the asset life
 - Impairments – write down through impairment loss & accumulated impairment
 - Disposals/ Sales of PPE – record gain/loss (if needed)
- Natural Assets – Depletion (similar to units-of-production depr.)
- Intangible Assets - Amortization
- FSA:
 - Fixed Assets Turnover
 - Total Assets Turnover



Major Activities of a Business:

What is left for us to cover?





Chapter 12

EQUITY

Goals for Lecture 10

Equity

- Raising equity financing (LO1)
- Corporations (LO2)
 - Corporate structure
 - Types of stocks
- Ownership of a corporation: Accounting for stock (LO3)
 - Common stock issuance (par value vs. no par value)
 - Preferred stock
 - Stock repurchase: Treasury stocks
- Retained Earnings (LO4)
 - Cash dividends & Stock dividends
- Other Equity Items: OCI & Reserves (LO5)

FSA

- EPS (Earnings per share)
- PE (Price Earnings) Ratio
- Dividend Payout Ratio

Capital Structure

Debt vs. Equity

- The acquisition of assets is financed from two sources:

1) Debt



Funds from creditors

2) Equity



Funds from owners

- Mixture of debt and equity that a company uses is called its “**capital structure**”

Q: Which type of financing do you think is more risky?

Financing Activity of a Business

- Difference between debt financing & equity financing:

Loan (Debt Financing)	Investment (Equity Financing)
Company is <u>obligated to repay</u> the principal amount, even during bad times.	Company is <u>not obligated</u> to repay the principal amount (investors can lose all of their investment).
Lender does not share in the success of the company. <i>(i.e. company will only repay the borrowed amount)</i>	Investor shares in the success of the company. <i>(i.e. investors get a share of the company's profit through dividends & enjoy capital gain from any rise in stock price)</i>

Q: Which type of financing would you go for if you are a startup?

RECAP: Types of Businesses

Recall from Lecture 01, you can typically set up a business as:

(1) Sole Proprietorship

- Owned by a single individual. Not a legally separate entity from its owner! (i.e. owner has unlimited liability!)
- Usually small in size, common in the service, retailing and farming industries.



(2) Partnership

- Owned by two or more individuals. Not a legally separate entity from its owners.



(3) Corporation

- A legal entity separate entity from its owners.
- At its simplest, a corporation is like an “artificial legal” person, created by a legal process. It has rights similar to that of a human being.
 - A corporation can own property, pay taxes, exist for an indefinite period, sue, and be sued.
- Ownership represented by shares of stock – can be privately or publicly owned (public company).



**OUR
FOCUS**

Corporations

Advantages & Disadvantages

Advantages:

- Separate legal entity
- Limited liability for the stockholders (i.e. they are not personally liable for the acts or obligations of the corporation, only liable up to their share of investment)
- Continuity of life (its own entity, and can “live on” for eternity)
- Ease in transferring ownership (easy to buy and sell stock on the stock exchange)
- Opportunities to raise large amounts of money by selling shares to a large number of people.

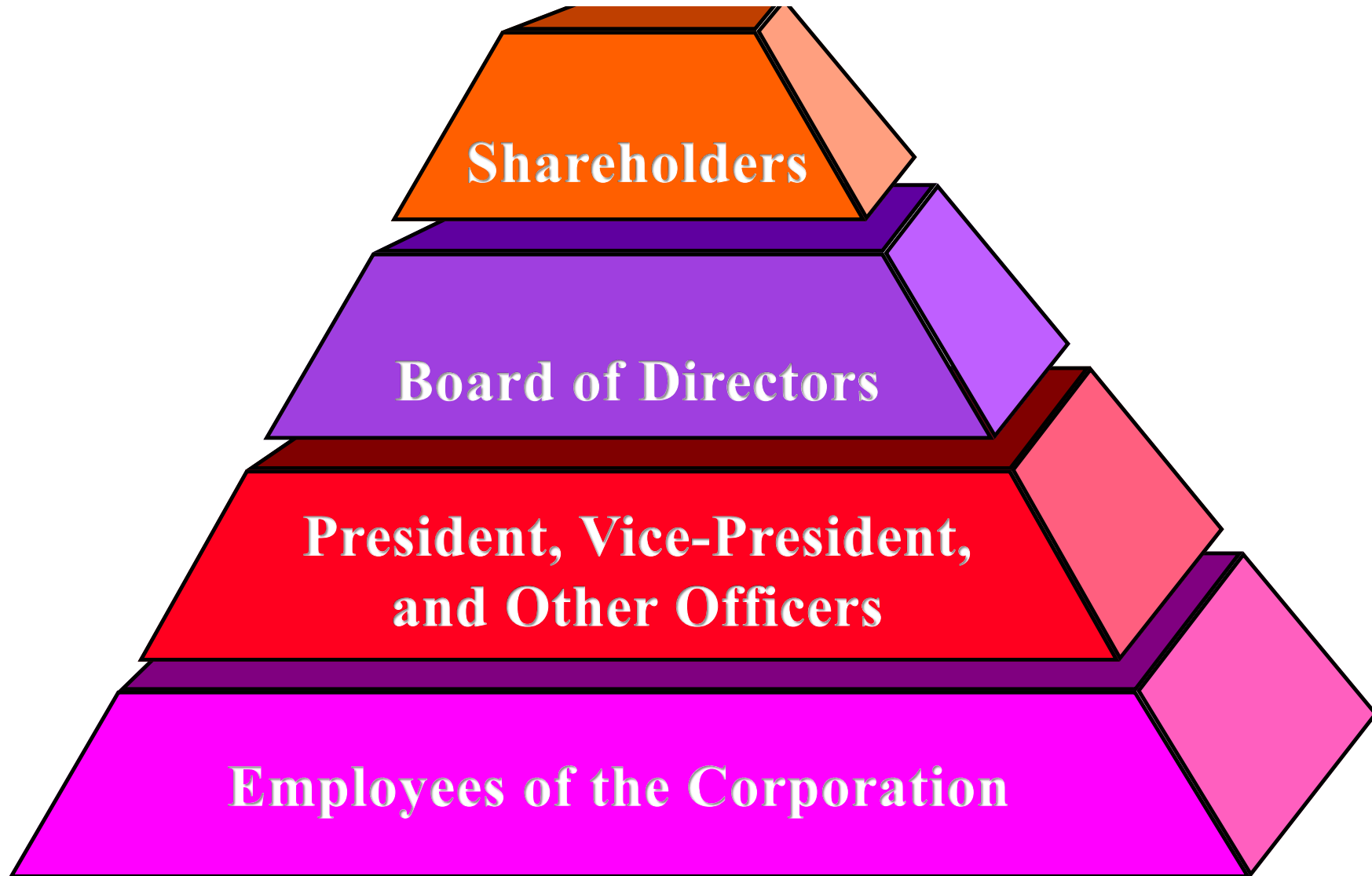


Disadvantage:

- Government regulation
- Double taxation (i.e. income is taxed “twice”: once when it is earned at the corporate level, and again when it is distributed to stockholders as dividends).
 - Note that certain countries, like Singapore and Hong Kong, have a one-tier tax system, i.e. they do not tax dividends! This makes them an attractive place for companies to do business.



Corporate Structure



Shareholders' Rights

Shareholders/stockholders: people who invest in a corporation.

(1) Vote at shareholders' meetings (voting rights)

- To elect board of directors and approve business matters (either in person or by proxy at the stockholders' meeting)

(2) Purchase additional shares / Sell shares

- Capital gain: when stock prices rise, shareholders can sell ownership for profit

(3) Receive dividends (dividends rights)

- Proportionate share on the distributions of profits

(4) Residual Claim (corporate assets rights)

- Proportionate share on the distributions of remaining assets upon liquidation of the company. (Creditors are paid before shareholders in the event of liquidation or bankruptcy)



Ownership of a Corporation

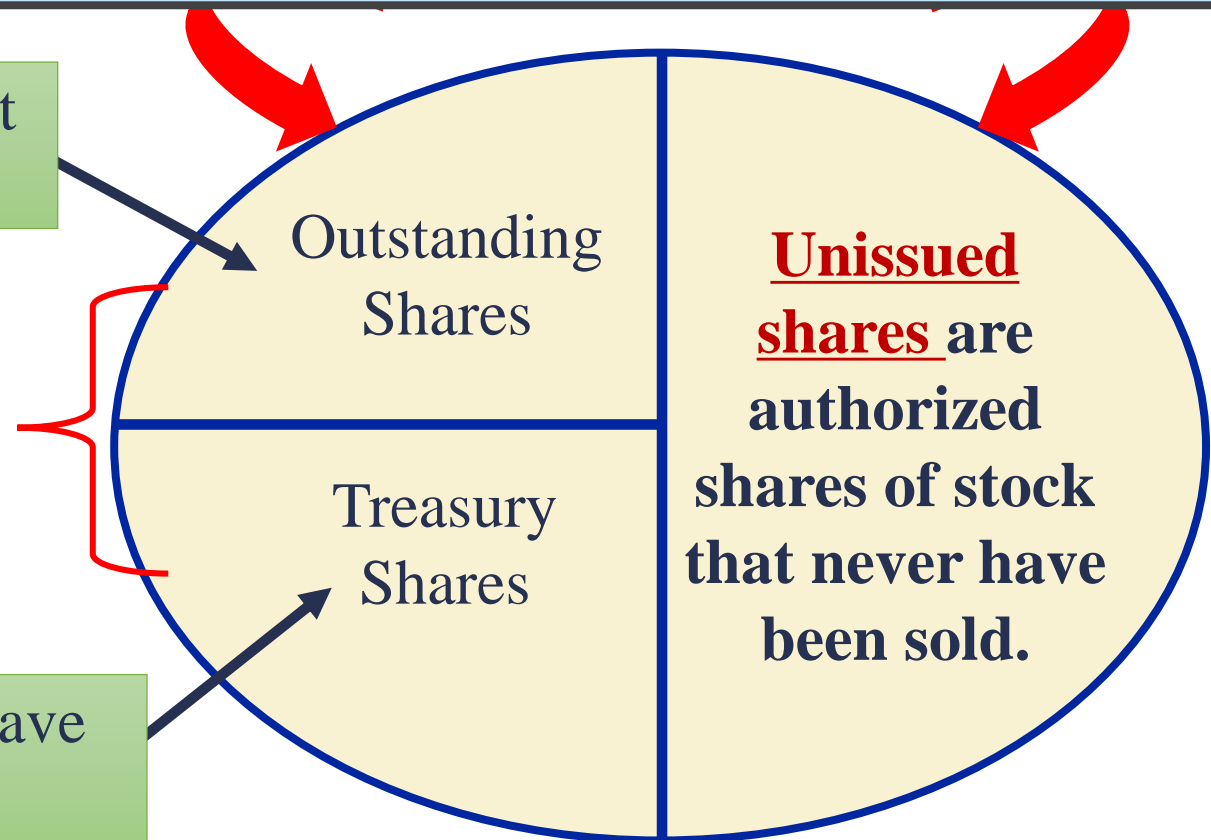
Authorized, Unissued, Issued, Outstanding & Treasury Shares

Authorized shares are the maximum number of shares of capital stock that can be sold to the public. (Stated in the corporate charter)

Outstanding shares are issued shares that are owned by stockholders.

Issued shares are authorized shares of stock that have been sold.

Treasury shares are issued shares that have been reacquired by the corporation.



Ownership of a Corporation

Par Value vs. No Par Value

Par Value

- An arbitrary (nominal) amount assigned to each share of stock when it is authorized.
- When par-value stock sells for above par, it is said to sell at a premium.
- NOT related in any manner to market value which is the selling price of a share of stock!

No Par Value

- No arbitrary amount is assigned to each share of stock.
- A “stated” value can be assigned to calculate the amounts to be recorded upon issuance of the shares

In Singapore, we use NO PAR value shares, and there is also no authorized share capital in Singapore.

Ownership of a Corporation

Major Types of Shares – Ordinary

(1) Ordinary Shares

- Basic voting stock issued by a corporation – usually one share one vote
- Entitled to receive dividends declared
- Rank behind Preference Shares in dividends and (usually) liquidation
- Can have different voting rights – e.g. dual class shares
- Can have preemptive rights: permits existing stockholders to purchase additional shares to maintain the same percentage of ownership



Ownership of a Corporation

Major Types of Shares - Preferred

(2) Preferred Shares

- Often has no voting rights
- Often has specific payment terms that takes priority over ordinary shares – e.g. fixed rate dividends (needs to be paid before ordinary shares receive dividends)
- (Usually) rank before ordinary shares in dividends and liquidation
- Classification of preferred shares:
 - *Convertible / non-convertible* – convertible to ordinary shares
 - *Redeemable / non-redeemable* – option for company to “buyback” the shares
 - *Cumulative / non-cumulative* – cumulative shares require all dividends in arrears (outstanding unpaid dividends from past years) to be fully paid before ordinary dividends can be paid out.
 - *Participating / non-participating* – participating shares may receive additional dividend based on predetermined condition.

Issue of Ordinary Shares (with par value)

(1) Issuance for cash at premium:

- StartMeUp Company issues 1,000 ordinary shares of \$1 par-value for \$5 per share. The issue is fully paid and received in cash.

Cash (1,000 x \$5)	\$5,000	
Common Stock (1,000 x \$1)		\$1,000
Paid-in Capital in Excess of Par		\$4,000

(2) Issuance for Acquisition of Asset (based on market value of shares)

- StartMeUp issues 5,000 ordinary shares of \$1 par-value to a shareholder in exchange for land. Fair market value of the land cannot be determined. Market value of the share on date of transaction is \$7 per share.



Land (5,000 x \$7)	\$35,000	
Common Stock (5,000 x \$1)		\$ 5,000
Paid-in Capital in Excess of Par		\$30,000

Issue of Ordinary Shares (No par)

(1) Issuance for Cash:

- StartMeUp Company issues 10,000 no par value ordinary shares. The issue is fully paid and the proceeds are \$20,000.

Cash	\$20,000	
Common Stock— ordinary no par shares		\$20,000

(2) Issuance for Acquisition of Asset (based on market value of asset)

- StartMeUp issues 5,000 no par value ordinary shares to purchase an equipment with a fair value of \$50,000. Share price on date of transaction is \$7 per share.

Equipment *	\$50,000	
Common Stock— ordinary no par shares		\$50,000

** If fair market value of the asset can be determined, then that is used as the basis for recording the transaction*



Issue of Ordinary Shares (No par with stated value)

(3) Issuance of stated value shares:

- StartMeUp Company issues 10,000 no par value ordinary shares with stated value of \$4 for \$5 per share.

Cash	\$50,000	
Common Stock— ordinary no par shares		\$40,000
Common Stock Premium – ordinary		\$10,000

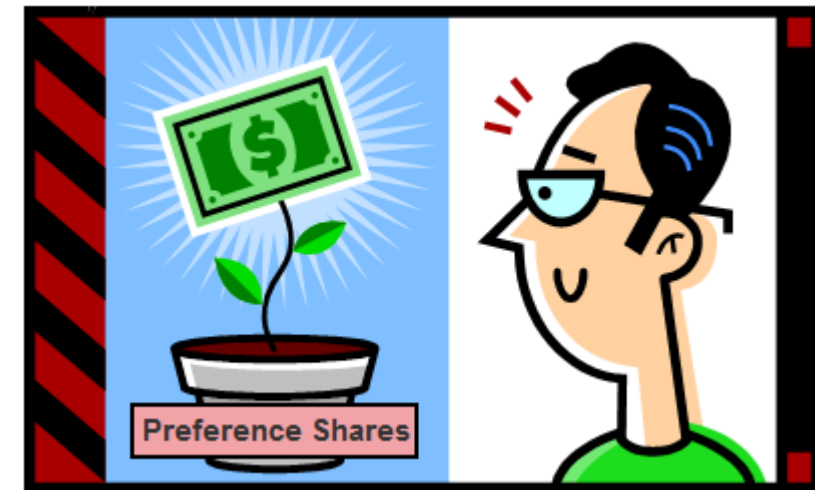
(Note on different terminologies: “Common Stock” can also be referred to as “Share Capital” or “Common Share”. “Common Stock Premium” or “Paid-in Capital in excess of par” can also be referred to as “Share Premium”)



Preferred Shares

Reasons for Issuing Preference Shares

- To raise capital without sacrificing control
- To boost the return earned by ordinary shareholders through financial leverage
- To appeal to investors who may believe the ordinary shares are too risky or that the expected return on ordinary shares is too low



Issue of Preferred Shares

UOB issued 3,000 class E* non-cumulative non-convertible preference shares.

No par preferred shares: Total proceeds from the issue was \$330,000.

Cash	\$330,000
Preferred Stock— Class E	\$330,000

Par value preferred shares: Par value is \$100, issued for cash at \$110 per share.

Cash	\$330,000
Preferred Stock – Class E	\$300,000
Paid-in Capital in Excess of par, preferred	\$ 30,000

** Different classes of shares have different shareholder rights. Companies may use alphabets (A, B, C etc..) to name and differentiate its different classes of shares.*

Real FS

United Airlines (par value shares)

UNITED AIRLINES HOLDINGS, INC. CONSOLIDATED BALANCE SHEETS (In millions, except shares)

LIABILITIES AND STOCKHOLDERS' EQUITY	At December 31,	
	2021	2020
Stockholders' equity:		
Preferred stock	—	—
Common stock at par, \$0.01 par value; authorized 1,000,000,000 shares; outstanding 323,810,825 and 311,845,232 shares at December 31, 2021 and 2020, respectively	4	4
Additional capital invested	9,156	8,366
Stock held in treasury, at cost	(3,814)	(3,897)
Retained earnings	625	2,626
Accumulated other comprehensive loss	(942)	(1,139)
Total stockholders' equity	5,029	5,960
Total liabilities and stockholders' equity	\$ 68,175	\$ 59,548

- With authorized (1,000,000,000) and par value (\$0.01) shares
- Types of shares : preferred (none), common, treasury
- FS prepared under U.S. GAAP

Source: United Airlines 2021 Annual Report (Form 10-K)



Real FS

Cathay Pacific (no par value shares)

SFP: CAPITAL AND RESERVES

Share capital	19	48,322	17,106
Reserves	21	24,935	45,667
Funds attributable to the shareholders of Cathay Pacific		73,257	62,773
Non-controlling interests		4	3
Total equity		73,261	62,776

- No par value shares
- Types of shares: Ordinary & Preferred

Source: Cathay Pacific 2020 Annual Report

Note 19: 19. SHARE CAPITAL

	2020		2019	
	Number of shares	HK\$M	Number of shares	HK\$M
Issued and fully paid				
Ordinary shares				
At 1st January	3,933,844,572	17,106	3,933,844,572	17,106
Shares issued on 10th August 2020 pursuant to rights issue	2,503,355,631	11,716	—	—
At 31st December	6,437,200,203	28,822	3,933,844,572	17,106
Preference shares				
At 1st January	—	—	—	—
Shares issued on 12th August 2020	195,000,000	19,500	—	—
At 31st December	195,000,000	19,500	—	—
		48,322		17,106



Real FS

Singapore Airlines (no par value shares)

		The Group 31 March	
	Notes	2021	2020
EQUITY ATTRIBUTABLE TO OWNERS OF THE COMPANY			
Share capital	13	7,180.2	1,856.1
Mandatory convertible bonds	14	3,496.1	–
Treasury shares	15	(133.2)	(156.0)
Other reserves	16	5,362.8	7,614.0
		15,905.9	9,314.1

- No par value shares
- Types of shares: Ordinary, Mandatory convertible bonds, treasury

Source: Singapore Airlines 2021 Annual Report

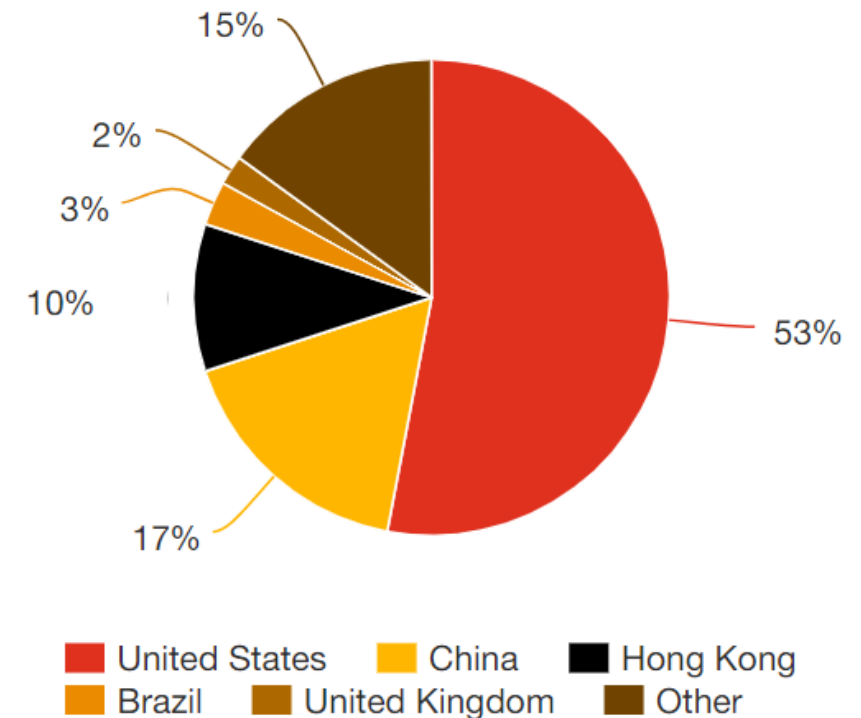


Share Issuance in Public Markets

IPO & SEO

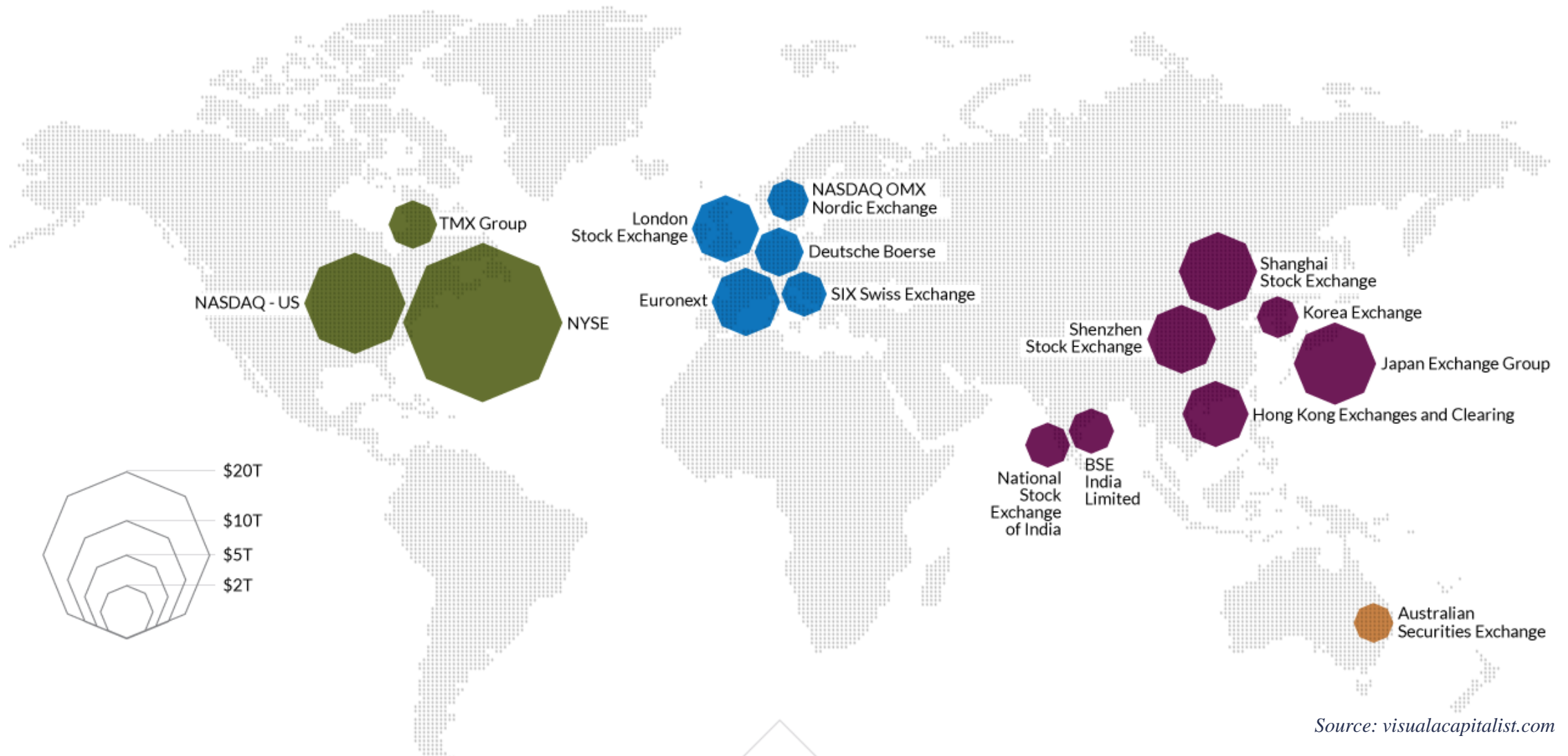
- Shares issuance to the public is made through:
 - (1) **Initial public offering (IPO)** - the first time a corporation sells shares to the public
 - (2) **Secondary/seasoned equity offering (SEO)** - subsequent sales of new shares to the public.
- Once the initial sale of shares (from the company to the investors) is done, investors can sell their shares to other investors in secondary markets. (e.g. New York Stock Exchange NYSE, Hong Kong Stock Exchange HKSE, Singapore Exchange SGX)
- Transactions between two investors in the secondary markets do **NOT** affect the corporation's accounting records!

Top countries 2020 (% of global IPO proceeds raised)



Source: Dealogic as of 31 December 2020.

World's Top 16 Stock Markets By size (market cap)



Source: visualacapitalist.com

Asia's Stock Market By size (market cap)



Source: visualcapitalist.com

Stock Repurchases:

Treasury Shares (Treasury Stock)

- Sometimes companies may want to buy back its shares from existing shareholders for various reasons.
 - To use their shares to acquire other companies
 - To purchase shares in order to avoid a hostile takeover
 - To reissue them to employees as compensation
 - To show management's confidence in the current price – stimulate trading
 - To give cash back to shareholders
 - To increase reported earnings per share (EPS) by reducing number of shares outstanding
- **Repurchased shares is called Treasury Shares/ Treasury Stock**
 - A corporation records treasury shares at cost.
 - Treasury shares has no voting or dividend rights.
 - Treasury shares is a *contra-equity* account.



Stock Repurchases (Share buyback)

Singapore Rules

- Companies listed on the Singapore Exchange (SGX) are subject to rules on share buybacks:
 - Need shareholders' approval
 - Should not do a share buyback when there are material developments or any unannounced material information
 - Should not create a “false market”:
 - Should avoid buying back near or at the close of the market
 - Should buy back at relatively low prices (no more than 105% of the average closing market prices over the last 5 consecutive active trading days)
 - Should not be excessive (more than 30% of daily volume of shares traded)



Repurchasing Treasury Shares

When a company repurchases its shares from investors, it records the transaction at cost.

WARREN BUFFETT | EARNINGS REPORT

Berkshire Continues Its Torrid Pace of Share Buybacks

By Andrew Bary Updated Feb. 27, 2021 9:58 am ET / Original Feb. 27, 2021 8:49 am ET

Text size  



Berkshire Hathaway bought back \$9 billion of stock in the fourth quarter as the company continued its aggressive share-repurchase program.

The fourth-quarter buybacks, which followed a similar \$9 billion of share repurchases in the third quarter, brought the total for 2020 to \$24.7 billion, up from \$4.9 billion in 2019.

E.g. Berkshire Hathaway repurchased 20,000 shares at \$400,000 per share from its shareholders.
Total cost = 20,000 x \$400k = \$8 billion

Treasury Shares*	\$8 billion
Cash	\$8 billion

**Treasury shares is a contra-equity account!*

BERKSHIRE HATHAWAY INC.

Real FS

Berkshire Hathaway Equity

- Berkshire Hathaway 2020 Annual Report : Equity section of the Balance Sheet

	December 31,	
	2020	2019
Shareholders' equity:		
Common stock	8	8
Capital in excess of par value	35,626	35,658
Accumulated other comprehensive income	(4,243)	(5,243)
Retained earnings	444,626	402,493
Treasury stock, at cost	(32,853)	(8,125)
Berkshire Hathaway shareholders' equity	443,164	424,791
Noncontrolling interests	8,172	3,772
Total shareholders' equity	451,336	428,563
	<u>\$ 873,729</u>	<u>\$ 817,729</u>

- Treasury Shares are shown as a *reduction* in total shareholders' equity on the Statement of Financial Position (Balance Sheet) as it is a contra-equity account.

Reissue of Treasury Shares

Berkshire Hathaway Example

- A company can reissue (sell) its treasury shares back to investors.
- E.g. Berkshire Hathaway reissued its treasury shares:

(a) At cost:

Reissue 5,000 treasury shares at \$400,000 per share, same price as the repurchase :

Cash (5,000 x \$400k)	\$2 billion
Treasury shares	\$2 billion

(b) Higher than cost:

Reissue 10,000 treasury shares at \$450,000 per share, higher than the repurchase:

Cash	\$4.5 billion
Treasury shares	\$4 billion
Premium on Treasury shares*	\$0.5 billion

* Can also be labeled as “Paid-in Capital, Treasury Stock”

Equity Account

BERKSHIRE HATHAWAY INC.

Reissue of Treasury Shares

Berkshire Hathaway Example (continued)

(c) Lower than cost: (sufficient balance in treasury share premium account)

Reissue 5,000 treasury shares at \$350,000 per share, lower than the repurchase:

Cash (5,000 x \$350k)	\$ 1.75 billion
Premium on Treasury shares (\$2b – \$1.75b)	\$ 0.25 billion
Treasury shares (5,000 x \$400k)	\$2 billion

(d) Lower than cost: (insufficient balance in treasury share premium account)

Reissue 5,000 treasury shares at \$300,000 per share, lower than the repurchase:

Cash (5,000 x \$300k)	\$1.5 billion
Premium on Treasury shares *	\$0.25 billion
Retained Earnings (\$2b – \$1.5b – \$0.25b)	\$0.25 billion
Treasury shares (\$5,000 x \$400k)	\$2 billion

* Note that the premium on treasury shares account only has a \$0.25 billion balance (\$0.5b from transaction (b) less \$0.25b “used” in transaction (c)). When the premium account does not have sufficient balance, then Retained Earnings will be reduced.

BERKSHIRE HATHAWAY INC.

Retained Earnings

Retained Earnings (RE):

- The portion of a corporation's equity that has been earned from profitable operations and not distributed to stockholders.
- Increase in RE : Net Income
- Decrease in RE: Net Loss, dividends distribution, some treasury stock transactions.
- Note that RE is NOT cash!



Distribution of Ordinary Dividends

- Companies distribute profits back to its shareholders through dividends.
- Dividends is not legally required, it is up to the company.
- Types of dividends:
 - Cash dividend – paid in cash to stockholders
 - Stock dividend – paid in stock to stockholders
- Regular cash dividends provides a return to shareholder.
- **To declare and pay dividends, the company will need to have:**
 - (1) Sufficient balance in retained earnings**
 - (2) Sufficient cash to pay the dividends (for cash dividends)**



Distribution of Cash Dividends

Important Dates

- Distribution of dividends involve three important dates:

(1) Declaration date - Board declares the dividends, company records a liability.

Dividends – Ordinary Shares XX

Dividends Payables

XX

(2) ***Date of record*** - Stockholders holding shares on this date will receive the dividend.

(NO accounting entry)

(3) *Date of payment* - Company pays the dividends.

Dividends Payables XX

Cash XX

- Recall that “Dividends” is a temporary account, so it needs to be closed out to Retained Earnings during the closing process:

Retained Earnings XX

Dividends

XX

Real FS

Cathay's Dividend

- Dividends declared and paid:

20. DIVIDENDS

(a) Dividends payable to ordinary shareholders attributable to the year

	2020 HK\$M	2019 HK\$M
No first interim dividend declared and paid for the year (2019: HK\$0.18 per ordinary share)	–	708
No second interim dividend proposed after the end of the reporting period (2019: nil)	–	–
	–	708

(b) Dividends payable to ordinary shareholders attributable to the previous financial year, approved and paid during the year

	2020 HK\$M	2019 HK\$M
No second interim dividend in respect of the previous financial year, approved and paid during the year (2019: HK\$0.20 per ordinary share)	–	787

Total dividends
paid in 2019:
For 2019 \$708
For 2018 \$787
Total \$1,495

Q: Why do you think Cathay did not distribute dividends in 2020?
Do you think it distributed dividends in 2021?

Cathay's Dividend – Cash outflow

- Cathay's Statement of Cash Flow – showing the cash outflow of dividends paid during the period:
 - Dividends were declared and paid only in 2019.

	Note	2020 HK\$M	2019 HK\$M
Financing activities			
New financing	11	22,304	16,975
Initial cash benefit from lease arrangements	14	–	837
Loan and lease repayments	11	(30,134)	(18,785)
Proceeds from issue of rights shares	19	11,716	–
Proceeds from issue of preference shares	19	19,500	–
Payments of transaction costs on issue of rights shares and preference shares		(77)	–
Dividends paid – to ordinary shareholders of Cathay Pacific		–	(1,495)
– to non-controlling interests		–	(1)
Net cash inflow/(outflow) from financing activities		23,309	(2,469)

Distribution of Preferred Dividends

Preferred stock has a dividend percentage associated with it - preferred dividends is paid according to the percentage.

Current-Dividend Preference

- Preferred stockholders has a right to receive current dividends before common stockholders receive dividends.

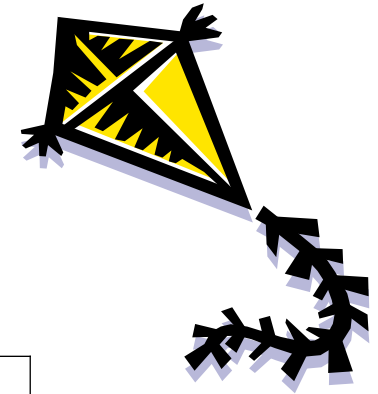
Cumulative-Dividend Preference

- It requires that preferred stockholders be paid dividend in arrears and current dividends before common stockholders receive any dividends.
- Dividends in Arrears = unpaid dividends from past years
- Dividends in arrears do not represent actual liabilities and thus are not recorded in the accounts. Instead, they are reported in the notes to the financial statements.

Preferred & Ordinary Dividends

An example

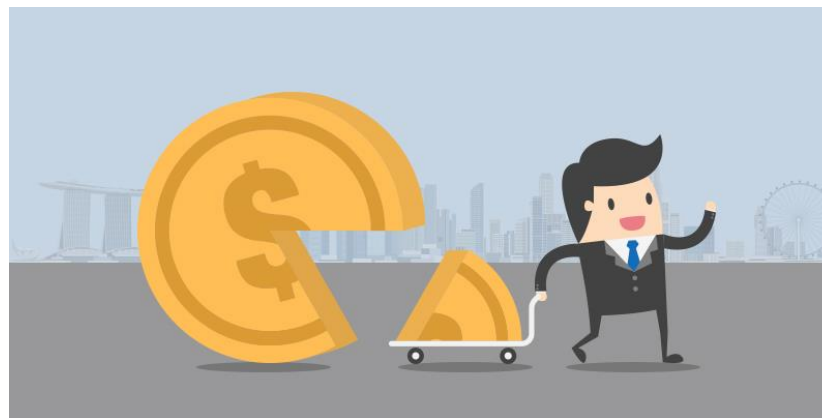
- Kites, Inc. declared \$50,000 dividends this year. It has the following shares outstanding:
 - Ordinary shares: 100,000 shares no par value
 - Preferred shares: 3%, \$100 liquidation preference, *cumulative*, 5,000 shares
 - Preferred shares: 6%, \$50 liquidation preference, *noncumulative*, 3,000 shares
- Dividends were not paid last year. How much will each class of shares receive?



Total Dividends Declared			\$ 50,000
<u>Preferred Shares (cumulative)</u>			
Dividend in arrears (last year unpaid balance) [3% x 5000 x \$100]	\$ 15,000		
Current year dividend [3% x 5000 x \$100]	\$ 15,000	\$ 30,000	
<i>Remainder</i>			<i>\$ 20,000</i>
<u>Preferred Shares (noncumulative)</u>			
Current year dividend [6% x 3,000 x \$50]		\$ 9,000	
<i>Remainder</i>			<i>\$ 11,000</i>
<u>Ordinary shares</u>			
Current year dividend		\$ 11,000	
Current year dividend per share [\$11,000 / 100,000 shares]		\$ 0.11	

Distribution of Stock Dividends

- Stock dividends – a form of dividends that requires a company to issue new shares to its shareholders without receiving cash.
- Small stock dividends: assigning the fair value.
- Large stock dividends: assigning the par value.
- The line between small and large stock dividends is often set at 20-25% of the company's issued shares.



Small Stock Dividends

- Macadamia & Co declares a 10% stock dividend (10,000 new shares). Its common stock has a par value of \$1 and market value of \$7.

@ Declaration date:

Stock Dividends (10,000 x \$7)	\$70,000	
Stock Dividends Distributable		\$10,000
Paid-in Capital in Excess of Par		\$60,000

@ Distribution date:

Stock Dividends Distributable	\$10,000	
Common Stock		\$10,000

@ Closing:

Retained Earnings	\$70,000	
Stock Dividends		\$70,000



Large Stock Dividends

- Macadamia & Co declares a 40% stock dividend (40,000 new shares). Its common stock has a par value of \$1 and market value of \$7.

@ Declaration date:

Stock Dividends (40,000 x \$1) \$40,000

Stock Dividends Distributable \$40,000

@ Distribution date:

Stock Dividends Distributable \$40,000

Common Stock \$40,000

@ Closing:

Retained Earnings \$40,000

Stock Dividends \$40,000

Equity Account



Stock Split vs. Stock Dividend

- Increasing number of shares outstanding in the same proportion that par or stated value per share decreases such that equity remains unchanged.
- E,g. 2-for-1 stock split: 1,000 shares of \$1 par → 2,000 shares of \$0.5 par
- During a stock split, the market value per share will also be reduced proportionately.
- Comparing stock split with stock dividend:

Items to be Affected	Stock Split	Stock Dividends
Number of shares outstanding	Increase	Increase
Total equity	No change	No change
Retained earnings	No change	Decrease
Common stock	No change	Increase
Paid-in capital in excess of par, common stock	No change	Increase (if any)
Par value per share	Decrease	No change

Other Comprehensive Income (OCI) & Reserves

OCI shows other items of income and expense that are not recognized in the profit or loss statement, such as:

- Exchange/currency differences in translating foreign operations
- Fair value revaluations
 - Equity investments designated at fair value
- Gain/loss not recognized in profit or loss statements:
 - Hedging instruments
- Changes in revaluation surplus



OCI items not recognized in the profit & loss statement are accumulated in an equity account called “**Reserves**” or as Other Equity.

Real FS - Cathay

Statement of Changes in Equity - Reserves

	Share capital HK\$M	Retained profit HK\$M	Investment revaluation reserve (non- recycling) HK\$M	Cash flow hedge reserve HK\$M	Others HK\$M	Total HK\$M	Non- controlling interests HK\$M	Total equity HK\$M
At 1st January 2020	17,106	45,867	(148)	634	(686)	62,773	3	62,776
Loss for the year	–	(21,648)	–	–	–	(21,648)	1	(21,647)
Other comprehensive income	–	599	–	(1,041)	1,435	993	–	993
Total comprehensive income for the year	–	(21,049)	–	(1,041)	1,435	(20,655)	1	(20,654)
Issue of rights shares	11,716	–	–	–	–	11,716	–	11,716
Issue of preference shares	19,500	–	–	–	–	19,500	–	19,500
Transaction costs on issue of rights shares and preference shares	–	(77)	–	–	–	(77)	–	(77)
At 31st December 2020	48,322	24,741	(148)	(407)	749	73,257	4	73,261



Self-study Question : P12-10

**Let us now work through the assigned self-study question
P 12-10 (Part 1) together.**

(If time permits, I will also cover Part 2)

FSA

FSA

- EPS (Earnings per share)
- PE (Price Earnings) Ratio
- Dividend Payout Ratio

Assessing Profitability

Earnings Per Share (EPS)

EPS:

$$\text{Basic Earnings Per Share} = \frac{\text{Net Profit} - \text{Preferred Dividends}}{\text{Weighted-average Ordinary Shares Outstanding}}$$

- Measures the profitability of a company: its ability to produce income for each ordinary share outstanding.
- EPS is probably the single most widely watched financial ratio, as per share basis number is easier to compare among companies.
- **Required disclosure on the Income Statement!**
- Companies must also disclose **diluted EPS** which assumed all convertible securities are converted into ordinary shares.

Real FS – Cathay

EPS Notes Disclosure

5. (LOSS)/EARNINGS PER ORDINARY SHARE

	2020			2019		
	Loss ^(a) HK\$M	Weighted average number of ordinary shares	Per share amount HK cents	Profit ^(a) HK\$M	Weighted average number of ordinary shares (restated)	Per share amount HK cents (restated)
Basic and diluted (loss)/ earnings per ordinary share	(21,876)	5,156,000,217	(424.3)	1,691	4,324,951,577	39.1



Real FS – SQ

EPS Notes Disclosure

11 Loss Per Share

	The Group			
	FY2020/21		FY2019/20	
	Basic	Diluted	Basic	Diluted
Loss attributable to owners of the Company (in \$ million)	(4,270.7)	(4,270.7)	(212.0)	(212.0)
Adjustment for the potential dilution from share-based incentive plans of subsidiary companies (in \$ million)	-	-	-	(0.3)
Adjusted net loss attributable to owners of the Company (in \$ million)	(4,270.7)	(4,270.7)	(212.0)	(212.3)
Weighted average number of ordinary shares in issue (in million)	3,694.7	3,694.7	1,887.1	1,887.1
Adjustment for dilutive potential ordinary shares (in million)	-	-	-	-
Weighted average number of ordinary shares in issue used for computing earnings per share (in million)	3,694.7	3,694.7	1,887.1	1,887.1
Loss per share (cents)	(115.6)	(115.6)	(11.2)	(11.3)



Assessing Market Expectations

Price-Earnings Ratio (PE Ratio)



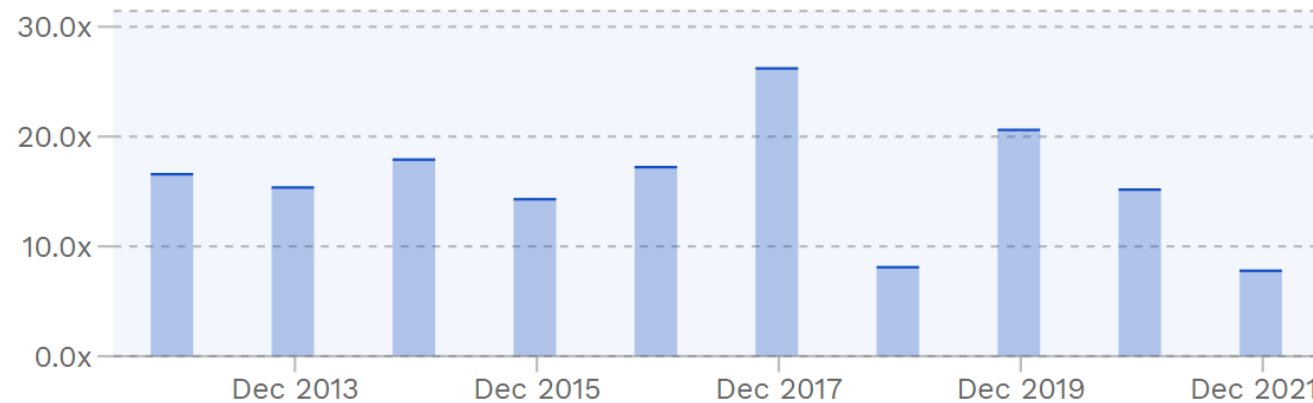
$$\text{Price-Earnings Ratio} = \frac{\text{Market value (price) per share}}{\text{EPS}}$$

- Measures what the market is willing to pay for the company's current earnings stream
- Extremely high PE ratio typically indicates a company is overpriced.

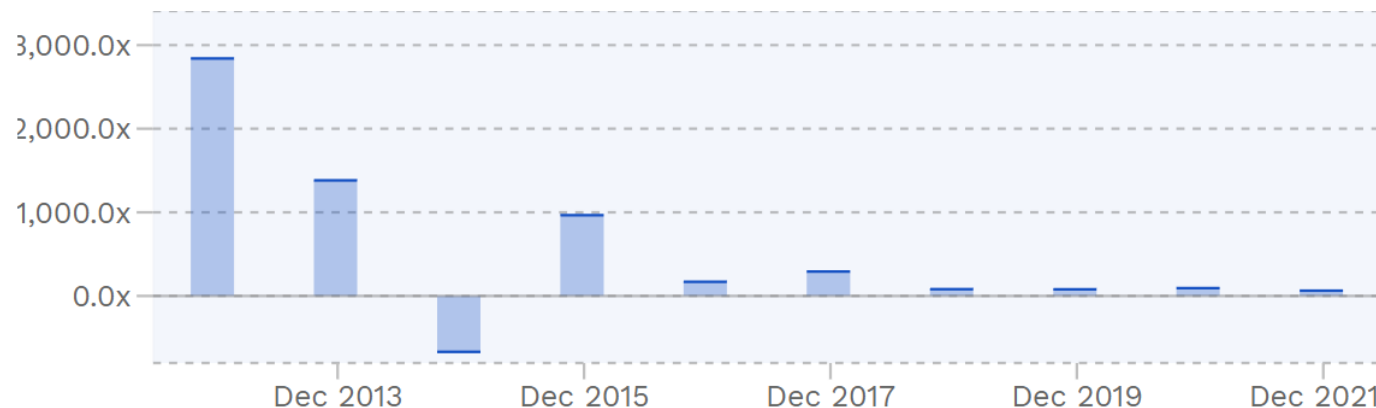
PE Ratios

Berkshire Hathaway & Amazon

- Berkshire Hathaway – well established blue chip company: more stable PE ratios



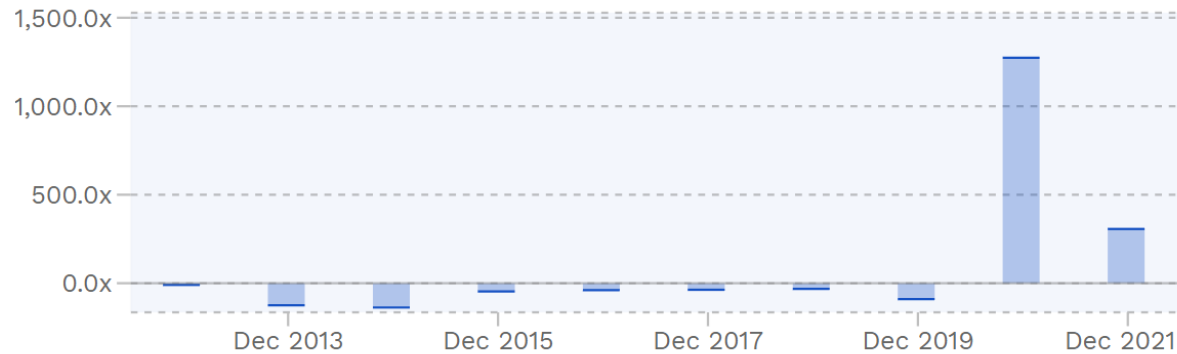
- Amazon – its PE ratio has stabilized in the last 4-5 years to around 70-90x, 2021 PE ratio is around 64x. But its peak in 2012 reached **3,732x**!



Source: www.finbox.com

Tesla's PE Ratio Journey

- Tesla's PE Ratio at the end of 2020 is **1,274x!**

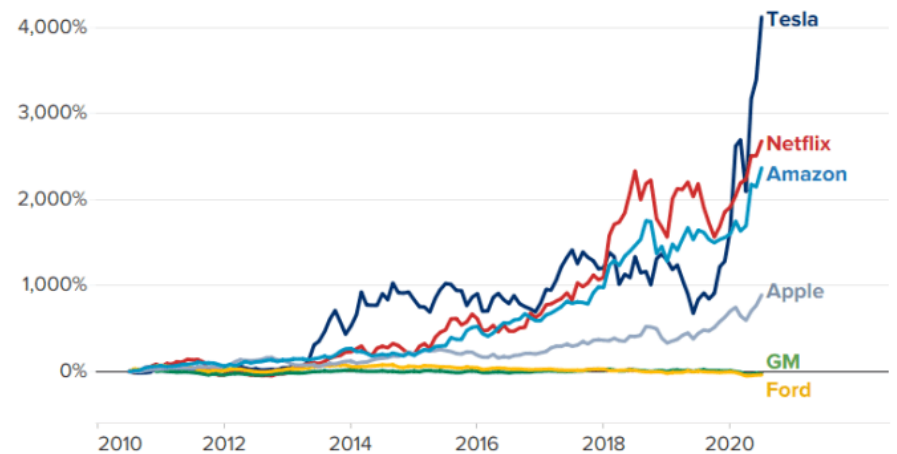


Source: www.finbox.com

- Its IPO price was US\$17. In July 2020, it was trading at US\$1,430! Note that up to that point, it has never achieved profitability.
- In Aug 2020, it did a 5-1 stock split and price post split was \$388. By Dec 2020, it was trading at \$705. Tesla finally reported positive net income for 2020 (US\$862m).
- At Dec 2021 it was trading at \$1,056. 2021 net income was \$5.6 billion! **At the end of 2021, its PE ratio was at around 350x.**
- It recently did another 3-1 stock split in Aug 2022, price post split was \$302. **Current PE ratio is about 80x at Oct 2022.**

Tesla's soaring stock

Stock performance since Tesla's IPO date of June 29, 2010



SOURCE: FactSet. Data shows return on a monthly basis through market close on June 29, 2020.



Dividend Payout Ratio

Dividend Payout Ratio:

**Dividend
Payout Ratio**

=

**Cash Dividends
Net Income**

- Measures the percentage of net income paid out during the year in the form of cash dividends.
- Shares that consistently pay large dividends are referred to as *income shares*
- Shares that distribute little or no dividends are typically called *growth shares*
- *E.g. Dividend Payout Ratio of some companies in 2019:*

	News Corporation	Microsoft	Intel	TSMC	Philips	Carrefour
Cash dividends	\$120	\$20,412	\$5,507	NT\$152,943	€649	€363
Net income	155	39,240	21,048	345,344	1,175	1,264
Dividend payout ratio . . .	77.42%	52.02%	26.16%	44.29%	55.23%	28.72%

Berkshire Hathaway's Dividend Payout Ratio: ZERO!

- Warren Buffet – one of the richest man in the world.
- His company Berkshire Hathaway, despite being a mature well-established company worth billions, has **NEVER** paid dividends!
- Warren Buffet does not believe in dividends, he believes that profits of the company should either be reinvested back into the company, used to acquire value companies or for stock repurchases.

BERKSHIRE HATHAWAY INC.

Dividends you say?
No way!
**I HATE
DIVIDENDS!!!!**



Take Away for Lecture 10

- Ownership of a Corporation
- Types of Shares and related transactions
 - Ordinary Shares –issuing par & no par
 - Preferred Shares – issuing par & no par
 - Treasury Shares – repurchasing & reissuing
- Dividends – cash & stock dividends
- FSA:
 - EPS (Earnings per share)
 - PE (Price Earnings) Ratio
 - Dividend Payout Ratio



See you next week!



Post your questions on Canvas discussion forum.

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