**Chapter 6 Earnings per share (IAS 33)**

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| **EPS is regarded as the most important indicator of a company’s performance**   * IAS 33 applies to listed companies both to parent and group accounts are required to comply   **Basic EPS:**  **Basic EPS = Earnings ÷ Shares**   * Should be expressed as cents per share to one decimal place.   + Earnings : Group PAT less NCI and Preference dividend on irredeemable preference shares   + Shares: weighted average number of shares outstanding during the period.   **When shares are issued at full market price**: Earnings divided by weighted average number of shares (time is the wright)  **Bonus Issue:**   * + Not provide additional resources   + Shareholder owns the same proportion of shares before and after the issue   + Bonus shares are deemed to have been issued from the beginning of the year even they are issued during the year   + Comparative figures (P/Y) are restated to allow for proportional increase in share capital caused by bonus issue (Previous year EPS x reverse bonus fraction)   **Bonus and market issue combined**:  If both bonus issue and issue shares at full price:   * + - Apply the bonus fraction from the start of the year up until the date of the bonus issue     - Time apportion the number of shares to reflect the cash being received from the market issue   **Rights Issue:**  Rights issue present special problems   * + - They contribute additional resources   They are normally priced below full market price | * + It combines both full market price + bonus issue   + Calculation of weighted average capital involves two elements   + 1) Adjust bonus element in rights issue = capital in issue before the rights issue x Bonus fraction   + Bonus fraction = Market price ÷ Theoretical price   + Theoretical price = weighted average price   3 shares existing @ 4 = 12  1 bonus share@ 3 = 3  Total 4 shares – value = 15  Theoretical price = 15/4 = 3.75   * + 2) Calculate the weighted average capital in the issue   + Restate previous year EPS=   Previous year EPS x inverse of bonus faction.  **Diluted EPS**   * Equity share capital may change in the future owing to circumstances which exist now known as dilution. This calculation alerts the shareholder to the potential impact on EPS * The examples of dilutive factors are * Conversion terms of convertible bonds, convertible preference shares, Exercise price for options and subscription price for warrants * To deal with potential ordinary shares, adjust basic earnings and number of shares assuming convertibles, options etc. had converted to equity shares on the first day of the accounting period or on date of issue if later. * DEPS = (Earnings + notional extra earnings ) / Number of shares + notional extra shares   **Convertibles bonds and preference shares:**   * The interest or dividend would be saved, hence earnings will increase, here consider the tax implications if any * Number of shares would increase | **Options and Warrants:**   * + An option or warrant gives the holder the right to buy shares at some time in future at a predetermined price   + Cash will be received at the time the option is exercised and DEPS calculation must allow for this   + The total number of shares issued on the exercise of the option or warrant is split into two     - The number of shares that would have been issued if the cash received had been used to buy shares at fair value (using average price during the year)     - Remainder which are treated like a bonus issue ( having been issued for no consideration)     - Number of shares issued for no consideration is added to the number of shares when calculating DEPS   No of free shares = No of options x (fair value – exercise price) /Fair value  **Importance of EPS**   * Used to calculate PE ratio * PE ratio is a major stock exchange yard stick * PE ratio = Market price of share / EPS   **Importance of DEPS**   * It shows what the current year EPS would be if all the dilutive potential ordinary share are in issue * Useful to assess trends in past performance * It serves as warning to equity holders   **Limitations of EPS**   * It does not take account of inflation * It is based on historic information and does not have a predictive value * Earnings are affected by the choice of accounting policy * DEPS is only an additional measures of past performance * EPS cannot be used as a basis of comparison between companies |  |