**Fundamental Analysis**

Fundamental analysis of a company involves looking at a company’s balance sheet and cash flow statements, which are usually updated every quarter, which is every three months when the company reports earnings. It’s important to keep in mind that looking at a single quarter’s metrics is only a snapshot of the company, and there are several metrics that each try to capture the health of the company, but in slightly different ways.

In a way, analyzing a company’s fundamentals is like going on a safari taking photographs of an antelope. A single still photo from one angle may tell you some things about the antelope, but taking multiple photos from different angles will give you a better view. Also, taking multiple photos over time will give you a sense of where the antelope is going. So before we introduce some commonly used metrics, please keep in mind that to get a better picture of a company that you’re trying to analyze, you’ll want to look at a collection of different measures over time.

**Sales Per Share**

A company’s revenue is based on its sales over that quarter, so we can think of sales and revenue as referring to the same thing. It’s a quick way to get a sense for how a company is doing, because we don’t have to subtract out cost of sales, which depends a bit on some accounting decisions. For example, if a company sells a million smartphones for a hundred dollars each over the past 3 months, then its revenue is $100 times 1 million, or $100 million. If the company issued ten million shares, then its sales per share is $100 million divided by ten million, or $10 per share.

You may be wondering why we bother dividing sales by the number of shares. This helps shareholders get a sense of how much the sales figures might impact a change in a single share price. You can imagine that if the company only issued 10 shares, a report of higher sales than forecasted would impact each share more than if the company issued ten million shares.

Also, note that sales of $10 per share probably does not mean that the shareholders will get $10 for each share that they own, or that their stock price will increase by $10. It costs money for the company to make each smartphone. Let’s take a look at a metric that accounts for cost of sales next.

**Earnings Per Share**

Earnings is the company’s revenue minus its cost of sales. Cost of sales refers to the cost of manufacturing the phone, employee wages, rent payments for office space, and the cost of equipment, like machines that make the phones. Earnings gives investors a sense of how much the equity of the company has changed over the past 3 months. Recall that stock represents a fractional ownership of a company’s equity.

Continuing with the smartphone company example, let’s say we can estimate the cost of sales per phone to be $80 per phone. If the sales per phone is $100, then the earnings per phone is $100 - $80 equals $20 per phone. With sales of one million phones, earnings would be $20 times one million, or $20 million.

With ten million shares, this is earnings of $20 million divided by ten million shares, which is $2 earnings per share.

Note again, that this $2 per share doesn’t mean that investors automatically receive an additional $2 per share in their pocket. Let’s look at one way that investors do receive some of those earnings by looking at dividends.

**Dividends Per Share**

After a company has positive earnings, they may decide to either reinvest the cash in growing the company’s business. A company’s executives are usually expected to make spending decisions based on maximizing shareholder value. Whether this always happens in practice is debatable, but ideally, if the executives decide that re-investing in the business yields lower returns than an investor could gain from investing in a similar business at the same level of risk, they will give some of the earnings to shareholders as cash. This cash is referred to as dividends.

Let’s say, for example, that the smartphone company decides to return $10 million of its earnings to its shareholders. The dividend per share is then $10 million divided by 10 million, or $1 per share.