What is earnings per share

Publicly owned companies must report earnings per share (EPS) below the net income line in their income statements. This is mandated by generally accepted accounting practices (GAAP). The EPS gives investors a means of determining the amount the business earned on its stock share investments. In other words, EPS tells investors how much net income the business earned for each stock share they own. It's calculated by dividing net income by the total number of capital stock share. It's important to the stockholders who want the net income of the business to be communicated to them on a per share basis so they can compare it with the market price of their shares.

Private businesses don't have to report EPS because stockholders focus more on the business's total net income.

Publicly-held companies actually report two EPS figures, unless they have what's known as a simple capital structure. Most publicly-held companies though, have complex capital structures and have to report two EPS figures. One is called the basic EPS; the other is called the diluted EPS. Basic EPS is based on the number of stock shares that are outstanding. Diluted earnings are based on shares that are outstanding and shares that may be issued in the future in the form of stock options.

Obviously this is a complicated process. An accountant has to adjust the EPS formula for any number of occurrences or changes in the business. A business might issue additional stock shares during the year and buy back some of its own shares. Or it might issue several classes of stock, which will cause net income to be divided into two or more pools - one pool for each class of stock. A merger, acquisition or divestiture will also impact the formula for EPS.