

Week 1 - DQ 2

What are the differences between basic and diluted earnings per share? What are the differences between the numerator and the denominator in the basic and diluted earnings per share calculations? What actions can an organization take in order to improve their earnings per share? What is the experience of either your organization or an organization that you are familiar with when it comes to any of these actions? As an investor, do you evaluate a company as a potential investment using basic or diluted earnings per share? Explain why.

Response #1

What are the differences between basic and diluted earnings per share?

The basic earnings per share exist in a simple capital structure where there is only common stock. Diluted earnings per share exists in a complex capital structure where there are stock options, warrants, dilutive convertible securities, and other rights other than just common stock.

What are the differences between the numerator and the denominator in the basic and diluted earnings per share calculations?

The formula for calculating basic EPS is the net income minus the preferred dividends divided by the weighted-average common shares outstanding. When calculating the diluted earnings per share the basic formula applies, but convertibles then options, warrants, and other dilutive securities are deducted from the basic formula.

What actions can an organization take in order to improve their earnings per share?

In my opinion, I would believe that an organization can increase their EPS by becoming more profitable by increasing net income. The second way is to decrease common shares outstanding by a share buyback.

What is the experience of either your organization or an organization that you are familiar with when it comes to any of these actions?

I have not worked for many years so my experience is limited.

As an investor, do you evaluate a company as a potential investment using basic or diluted earnings per share? Explain why.

If I were an investor, I would first examine the basic earnings per share then the diluted earnings per share. It seems to me that the basic EPS gives a snapshot of how the

organization is doing, but the diluted EPS gives the entire picture. I would want to know the EPS growth rate for the previous five years compared with industry standards.

Response #2 Basic EPS is based on the total EPS "outstanding" at the time. Diluted EPS is based on the total EPS "potentially available."

Basic is calculated by net income - preferred dividends / weighted-average shares outstanding. Diluted takes it further to include the impact of convertibles, stock options, warranties, and other dilutive securities, according to the textbook. Both use the weighted-average shares outstanding as the denominator.

Looking at articles online in regards to Apple it appears that they are company despite troubles with the economy has remained positive in their earnings per share. The main article I read was in 2009. It showed that the company increased EPS. I think their success may have been they had a product that was in high demand. They were and are continuing to come out with more models and upgrades. I think it will be interesting to see what their EPS does over the next few years as Android products continue to swarm the market and competition is quickly increasing.

I would think to increase EPS a company would need to either decrease their number of shares which would make individual shares higher, or to increase profits.

I have never evaluated potential investments but from what I have began reading this week, diluted is the best method as it produces more conservative numbers and accounts for more possibilities (less surprises).

Response #3 One difference is that basic earnings per share do not take into account the effect of the company's securities that can be changed to common stock- dilutive securities. Both differ in that diluted earnings per share evaluated all possible things that may reduce shareholder's earnings per share, while basic EPS are design for a simple capital structure. Earnings per share (EPS) are calculated: net income less preferred stock dividends divided by the weighted - average of shares outstanding. The difference between the denominator and numerator in the calculations is that basic EPS depend on the number of weighted-average of shares outstanding, while diluted EPS includes the shares of convertibles or warrants outstanding in the outstanding shares number. To improve their earnings per share organization can purchase their outstanding stock, which will increase the return on equity and individual shares value as well. I read that Hewlett-Packard (among several others) spend \$10 billion in 2010 buying its shares. The reason: companies do not want to create new services or products while consumer demand is weak. I am not an investor but

this week readings show that investors prefer to evaluate an organization as a potential investments by using diluted earnings per share method because it takes into consideration diluted securities and other potential issuances of common stock that could affect EPS.

Response #4 The equation for both the basic and diluted earnings per share (eps) start the same. The basic EPS is the net income – the preferred dividends divided by the weighted averages shares outstanding. The difference is that the diluted ESP also subtracts the impact of convertibles and it also subtracts the impact of options, warrants, and other diluted securities. According to our book, the denominator is the weighted-average number of shares outstanding and the numerator is the net income. The denominator will increase when additional shares are issued while the numerator increases when the interest expense amount increases. To improve the earnings per share, the company can buy back stock. I am currently not familiar with this aspect in the workforce being that I have never worked for a company where this has been addressed with me. I am also not an investor so I would have to do a lot of research to determine which exactly I would want to focus on. I believe that the book talks about using the diluted earnings per share because this method takes the diluted issuances of common stock into consideration.