Earnings Per Share & Issue of Stock Shares

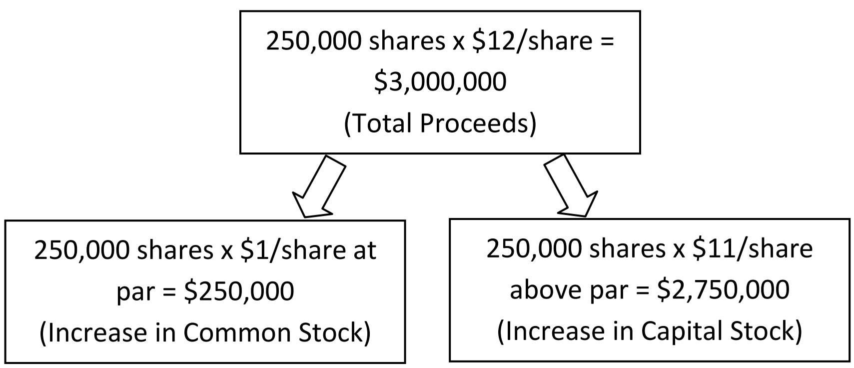
Earnings per share (abbreviated EPS) is the amount of net income earned per share of common stock. To find out this value, take the total net income for a year divided by the number of shares of common stock:

$$EPS = {}^{Net\ income}/_{\#\ shares\ of\ common\ stock}$$

You may be asked to update a balance sheet to reflect the issuance of stock. There are a couple of basic steps that will keep you on track with solving these types of problems.

(1) The first step is to calculate the value added to common stock and capital stock accounts. Remember that <u>only</u> the par value of the stock is used to determine the amount added to common stock account balance. If stocks are sold for a price above the par value, the difference between selling price and par value is used to determine the amount added to the capital stock account balance.

If 250,000 shares of stock (par value $1) were sold for $12, what are the increases in the common stock and capital stock accounts?



(2) Calculate the value of designated proceeds. For example, after the issuance of 250,000 shares, 50% of the proceeds are used to pay down long-term debt, 30% to buy fixed assets and the rest is deposited into the corporate bank account. Using the example above of 250,000 shares issued at $12/share, what will be the accounts affected and the amount of change in each account?

Identify the TOTAL PROCEEDS. This will always be the number of shares issued times the selling price. Then calculate the designated percentages.

0.50 x $3,000,000 = $1,500,000 to pay down long-term debt. This REDUCES the debt, so we subtract this amount from the long term debt account balance.

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0.30 x $3,000,000 = $900,000 to purchase fixed assets. This INCREASES the account balance of fixed assets.

The remainder is 100% - 50% - 30% = 20%
0.20 x $3,000,000 = $600,000 deposited into the corporate bank account. This means CASH. So $600,000 is added to the cash account balance.

(3) Recalculate the total balances as needed (in this case, total current assets, total assets, total liabilities and total OE and total liabilities + OE would all need adjusting). CHECK THAT TOTAL ASSETS = TOTAL LIABILITIES + OWNER'S EQUITY.

You may be asked to evaluate how EPS will change with the issuance of more shares of common stock. Stockholders will be happier with a higher EPS – meaning each share of common stock they own is returning a higher net income.

Case Study

The following is the balance sheet for Lupo Industries as of December 31, 2009. In 2008 the business generated a net income of $28,000.

Lupo Industries
Balance Sheet, December 31, 2009

Current Assets		Current Liabilities	
Cash	40,530	Wages Payable	4,200
Marketable Securities	17,420	Accounts Payable	8,500
Accounts Receivable	15,790	Notes Payable	6,700
Inventory	12,880	Interest Payable	2,350
Prepaid Expenses	10,600	Total Current Liabilities	21,750
Total Current Assets	97,220		
		Long term Debt	640,800
Fixed Assets			
Land	90,500	Total Liabilities	662,550
Building	821,400		
Equipment	213,900	Owner's Equity	
Furnishings	74,730	Common Stock 60,000 shares outstanding ($5 par)	300,000
Net: Accumulated Depreciation	(105,100)	Paid in Capital	150,000
Total Fixed Assets	1,095,430	Retained Earnings	80,100
		Total Owner's Equity	530,100
Total Assets	$1,192,650	Total Owner's Equity + Liabilities	$1,192,650

(a) Calculate the EPS in 2008.

(b) Assume that in 2009, Lupo Industries issues 20,000 more shares of $5 par value common stock for a market price of $15 per share. Of the proceeds, 40% will be used to pay down long term debt, 30% will be used to buy equipment, 20% will be used to buy furnishings and the remainder will be deposited in the corporate bank account. (Assume depreciation does not change). Compile the balance sheet after the new stock issue.

(c) Assume Lupo Industries generates a net income of $32,000 in 2009 (after the issuance of new shares). Determine the new earnings per share and comment on the shareholders' response to this new issue of stock.

Solutions

(a) EPS = $0.47/share

(b) Grey shading indicates a change due to issue of shares of stock.

Lupo Industries

Balance Sheet, December 31, 2009

Current Assets		Current Liabilities	
Cash	70,530	Wages Payable	4,200
Marketable Securities	17,420	Accounts Payable	8,500
Accounts Receivable	15,790	Notes Payable	6,700
Inventory	12,880	Interest Payable	2,350
Prepaid Expenses	10,600	Total Current Liabilities	21,750
Total Current Assets	127,220		
		Long term Debt	520,800
Fixed Assets			
Land	90,500	Total Liabilities	542,550
Building	821,400		
Equipment	303,900	Owner's Equity	
Furnishings	134,730	Common Stock 80,000 shares outstanding ($5 par)	400,000
Net: Accumulated Depreciation	(105,100)	Paid in Capital	350,000
Total Fixed Assets	1,245,430	Retained Earnings	80,100
		Total Owner's Equity	830,100
Total Assets	$1,372,650	Total Owner's Equity + Liabilities	$1,372,650

(c) EPS = $0.40/share. Stockholders will be less satisfied as the EPS has decreased.