Earnings Per Share (EPS)

Earnings Per Share (EPS) is calculated as the company's profit divided by the current outstanding shares of stock. This is considered to be the "bottom line" when a company reports earnings and shows how profitable (or unprofitable) the company was able to perform over the reporting period.

The formula for basic EPS is as follows:
Basic EPS = (Net Income – Preferred Dividends) / Weighted average number of outstanding common shares.

Investors can then use the EPS to help determine how cheap or expensive the company is trading using the P/E Ratio and decide whether or not they would like to invest in it.

Investors should see consistent increases in EPS year-over-year and quarter-over-quarter in a quality compounding business strategy. It may not be every year and every quarter—some downturns bring down the earnings of even the best companies, as we saw with many companies in both 2008 and 2020. But over the long run, consistently rising EPS tends to lead to a rising stock price.

Earnings per share can increase if the company uses share repurchases to lower the number of outstanding shares by decreasing the denominator in the Basic EPS equation. On the other hand, if the company is diluting shareholders by issuing more shares of common stock, the EPS will fall due to the denominator becoming incrementally larger.

EPS is a key tool in evaluating the profitability of a business, and its attractiveness for investment. Like any accounting metric, it can be gamed by management teams—so it's important to study the footnotes of financial statements to understand what adjustments might need to be made, as well as look for trends over time rather than relying on any single year when using EPS to help make an investment decision.