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LKAS 33 - Earnings per share

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OBJECTIVE

SCOPE

MEASUREMENT

Basic earnings per share

Earnings

Weighted average number of shares

Basic EPS related issues

Diluted earnings per share

Basics

Other related issues

PRESENTATION, DISCLOSURE ,EFFECTIVE DATE

OBJECTIVE

**Prescribe
principles for the
determination and
presentation of
earnings per share**

**Improve
performance
comparisons
between entities &
same entity over
time**

Scope

whose ordinary
shares or
potential
ordinary shares
are publicly
traded

Shall be applied
by the entities

that are in the
process of issuing
ordinary shares or
potential ordinary
shares in public
markets

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Scope (Contd.)

1. Is it allowed for an unlisted company to present EPS in their F/S?

- **Yes**
- **Not mandatory**
- **If opted to disclose ,EPS shall be calculated and presented in accordance with this**

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Scope (Contd.)

2 Should EPS be presented on the basis of both consolidated and separate F/Ss, in a set of consolidated F/Ss?

- **No ,it shall be only on the basis of Consolidated information**
- **But not restricted , if chooses shall present EPS on Separate F/Ss and that shall be disclosed only on separate statement comprehensive income.**

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Measurement

An entity shall compute both :

Basic EPS

Diluted EPS

**Basic EPS
(continuing
operations)**

**Diluted EPS
(continuing
operations)**

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Measurement (Contd.)

How is earnings per share measured?

- Basic earnings per share (for a period) =

Net profit or loss attributable to ordinary shareholders
Weighted average number of ordinary shares
outstanding

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Measurement (Contd.)

How is earnings per share measured? (Contd.)

- Basic earnings per share (for a period) =

Net profit or loss – Preference dividend(after tax) – Adj.*
Weighted average number of ordinary shares outstanding

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Measurement (Contd.)

How is earnings per share measured? (Contd.)

Basic earnings per share (for a period) =

Dividend iro Preference shares classified as equity - LKAS 32

Paid iro of non cumulative preference shares, Declared or not declared iro cumulative preference shares

Net profit or loss - Preference dividend(after tax) -/+ Adj.*
Weighted average number of ordinary shares outstanding

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Measurement (Contd.)

How is earnings per share measured? (Contd.)

Basic earnings per share (for a period) =

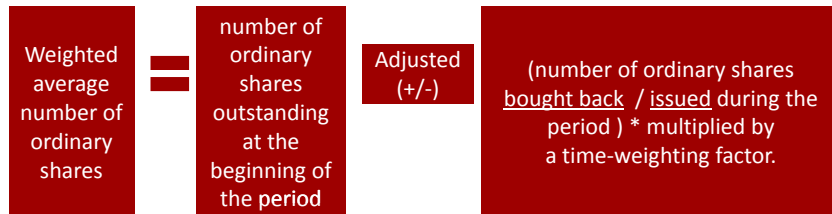
Any other adjustment iro preference shares classified as equity

Net profit or loss - Preference dividend(after tax) -/+ Adj.*
Weighted average number of ordinary shares Outstanding

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Measurement (Contd.)

How is Weighted average number of ordinary shares outstanding



The time-weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period.

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Measurement (Contd.)

How is Weighted average number of shares are computed?

Have a look in at the following example. What is the weighted average number of ordinary shares during the period?

Financial year end- 31 December

- Number of shares in issue 100,000# @ Rs 1 each
- New shares issued on 1 April 20,000 # @ Rs 1 each

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Measurement (Contd.)

How is Weighted average number of shares are computed? (Contd.)

- Answer
- 100,000 shares for three months and 120,000 shares for nine months. This calculates as 115,000.

100,000 shares for 3 months = $100,000 \times 3/12 = 25,000$

120,000 shares for 9 months = $120,000 \times 9/12 = 90,000$

TOTAL 25,000 + 90,000 115,000

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Measurement (Contd.)

How is Weighted average number of shares are computed?

Share Transaction

- Shares issued for cash
- Shares issued on conversion of debt
- Shares issued in exchange for the settlement of a liability
- Shares issued to acquire a non-cash asset
- Shares issued to acquire a business in a business combination.
- Shares issued on conversion of mandatorily convertible instrument

Dates from which shares are included

- Date cash is receivable
- Date interest on debt ceases to accrue
- Date of settlement
- Date when acquisition is recognized
- Acquisition date
- Date when the initial contract for the mandatorily convertible instrument is issued

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Basic EPS- Issues

- Treasury shares-

Should the number of ordinary shares be reduced by the number of treasury shares to arrive at the number of ordinary shares outstanding for the EPS calculation?

YES

Treasury shares are no longer outstanding and need to be deducted to arrive at the number of ordinary shares outstanding.

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Basic EPS- Issues (Contd)

Example

Financial year end- 31 December

Number of shares in issue 100,000# @ Rs 1 each

New shares issued on 1 April 20,000 # @ Rs 1 each

Company is holding 10,000 of its own shares (treasury shares) from the beginning of the financial year,

Profit attributable to ordinary share holders for the year is 25,000

Can you calculate the EPS ?

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Basic EPS- Issues (Contd)

Answer

Weighted average number of shares would be calculated as follows:

Number of shares for 3 months = $100,000 - 10,000 = 90,000$

Number of shares for 9 months = $120,000 - 10,000 = 110,000$

Weighted average number of shares 90,000 shares for 3 months
 $= 90,000 \times \frac{3}{12} = 22,500$

110,000 shares for 9 months $= 110,000 \times \frac{9}{12} = 82,500$

TOTAL $22,500 + 82,500 = 105,000$

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Basic EPS- Issues (Contd)

Shares held in employee benefit trusts

Another common situation where a company holds its own shares arises where it operates an Employee Share Ownership Plan (ESOP) for the benefit of its employees.

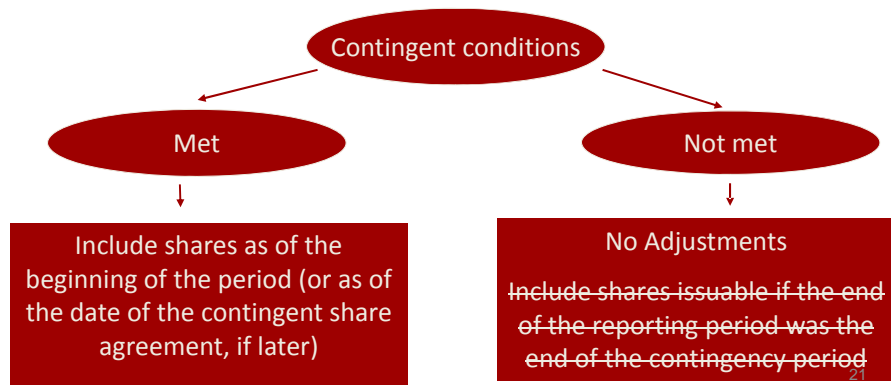
For the purpose of calculating EPS these outstanding shares should also be excluded from the calculation of basic EPS to the extent that they have not vested unconditionally in the employees.

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Basic EPS- Issues (Contd)

Contingently issuable shares

Should we include those in weighted average number of shares calculation?



Basic EPS- Issues (Contd)

Change in no. of share with no change in resources

- The weighted average number of ordinary shares outstanding **during the period** and **for all periods presented** shall be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources.



Basic EPS- Issues (Contd)

Change in no. of share with no change in resources

- (a) a capitalisation or bonus issue (sometimes referred to as a stock dividend);
- (b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;
- (c) a share split; and
- (d) a reverse share split (consolidation of shares).

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Basic EPS- Issues (Contd)

Issue of bonus shares – impact on No. of shares

- On 1 April, the Company made a bonus issue of 1 ordinary share for every 4 shares held:
- Financial year end- 31 December
- Last year EPS- Rs 0.20
- Number of shares in issue before bonus issued 100,000 @ Rs 1 each
- Profit for the year ending 31 December – Rs 30,000

Compute basic EPS for the current period

Is there any impact on previous year EPS reported?

If “yes” what is the impact?

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Basic EPS- Issues (Contd) Issue of bonus shares – impact on No. of shares (Contd.)

Basic EPS for the current period would be as follows:

Number of ordinary shares issued	= 100,000/ 4
	25,000
Total number of shares	= 100,000+25,000
Profit for the year (given)	= 30,000
EPS for the current year	= Rs 30,000/ 125,000
	= Rs 0.24

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Basic EPS- Issues (Contd) Issue of bonus shares – impact on No. of shares (Contd.)

**Is there any impact on previous year EPS reported?
If “yes” what is the impact?**

There is an impact on previous year EPS

The EPS for the previous year would be:

Profit of previous year
= Rs 0.20 * 100,000
= Rs 20,000

Therefore, the EPS is Rs 20,000/ 125,000

= Rs 0.17

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Basic EPS- Issues (Contd)
Issue of bonus shares – impact on No. of shares (Contd.)

Entity A had 400,000 ordinary shares outstanding for many years until 31 July 2011. On 1 August 2011, the entity made a bonus issue of 1 ordinary share for every 4 shares held.

Entity A's results after tax were as follows:

	2010		2011
Net profit after tax		1,040,000	
	3,200,000		

Question

How should management calculate the earnings per share for 2011? Should there be an adjustment to the earnings per share in 2010?

Basic EPS- Issues (Contd)
Issue of bonus shares – impact on No. of shares (Contd.)

Basic EPS calculations

Management should treat the bonus issue as if it had occurred prior to 1 January 2010, the earliest period presented. The calculation is as follows:

Solution

Number of shares after issue = $400,000 \times 5/4$

Earnings per share 2011 = $3,200,000 / 500,000 = 6.40$

Adjusted earnings per share 2010 = $1,040,000 / 500,000$

Basic EPS- Issues (Contd)

Effect of right issue – impact on No. of shares

- The issue of ordinary shares could have a bonus element, for example in a rights issue, where the exercise price is often less than the fair value of the shares.
- The calculation of EPS should consider the bonus element when calculating the number of ordinary shares outstanding prior to the issue.
- The following example illustrates how an entity should calculate basic EPS when a rights issue with a bonus element is issued during the period.

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Basic EPS- Issues (Contd)

Issue of bonus shares – impact on No. of shares (Contd.)

- Entity A makes a rights issue.
 - The terms of the issue are one new share for each five shares(1:5) held at an exercise price of 100.00.
The last date that a shareholder can take up the rights offer is 31 March 2011.
The number of shares outstanding prior to the rights issue was 625,000, and fair value of the shares on 31 March 2011 was 172.00.
The rights issue was fully taken up and 125,000 shares ($625,000 / 5$) were issued.
- The profit after tax for entity A was as follows:
- 2010: 10,000,000
2011: 12,000,000

Question

How should management calculate earnings per share?

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Basic EPS- Issues (Contd)

Issue of bonus shares – impact on No. of shares (Contd.)

Solution:

Management should perform the calculation of EPS in four steps:

- calculate the theoretical ex-rights value per share;
- calculate the adjustment factor to reflect the bonus element of the rights issue;
- use the adjustment factor to determine the number of shares to be used in the calculation of EPS for the periods prior to 31 March 2011; and
- calculate EPS.

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Basic EPS- Issues (Contd)

Issue of bonus shares – impact on No. of shares (Contd.)

Step 1 - Calculation of theoretical ex-rights value per share

$$\frac{\text{Fair value of all outstanding shares} + \text{total amount received from exercise of rights}}{\text{Number of shares outstanding prior to exercise} + \text{number of shares issued in the exercise}}$$

$$= \frac{(172.00 \times 625,000 \text{ shares}) + (100.00 \times 125,000 \text{ shares})}{625,000 \text{ shares} + 125,000 \text{ shares}}$$

$$= 160$$

Step 2 - Calculation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{172.00}{160.00} = 1.075$$

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Basic EPS- Issues (Contd)

Issue of bonus shares – impact on No. of shares (Contd.)

Step 3 – Use the adjustment factor to determine the number of shares to be used in the calculation of EPS for the periods prior to 31 March 2011

For the year ended 31/12/2010, the adjusted number of shares is
 $= 625,000 \times 1.075 = 671,875$

For the year ended 31/12/2011, the adjusted number of shares is
 $= (625,000 \times 1.075 \times 3/12) + (750,000 \times 9/12) = 730,468.75$

Step 4 – Calculate EPS

EPS for the year ended 31/12/2010 is
 $= 10,000,000/671,875 = 14.88$

EPS for the year ended 31/12/2011 is
 $= 12,000,000/730,468.75 = 16.43$

Two EPS Computations

Basic

Considers only common shares issued and outstanding.

Diluted

Reflects the maximum potential dilution from all possible stock conversions that would have decreased EPS.

Diluted EPS- What is diluted EPS?

- At the end of an accounting period, a company may have in issue **some securities**, which do not (at present) have any claim to a share of equity earnings but may give rise to such a claim in the future.

Such instruments are considered **potential ordinary shares**.

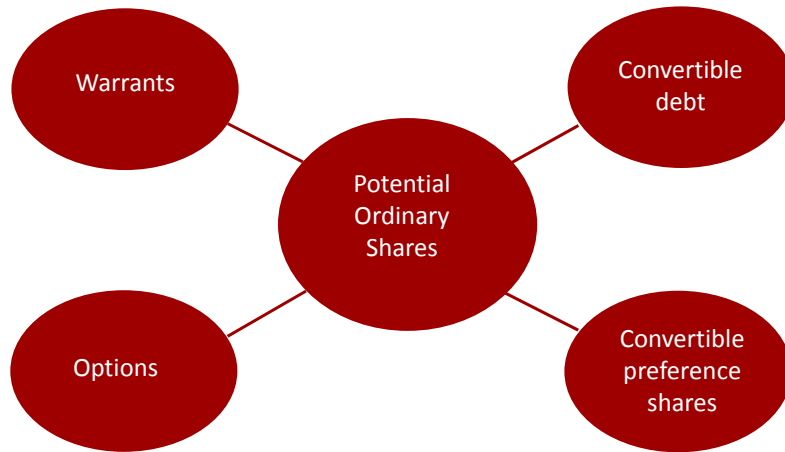
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Diluted EPS- What is diluted EPS? (Contd.)

- In such circumstances, the number of shares ranking for dividend might increase in the future, which in turn results in a fall in the earnings per share.
- A potential increase in the number of equity shares could cause a dilution of equity and it is necessary to calculate diluted earnings per share.

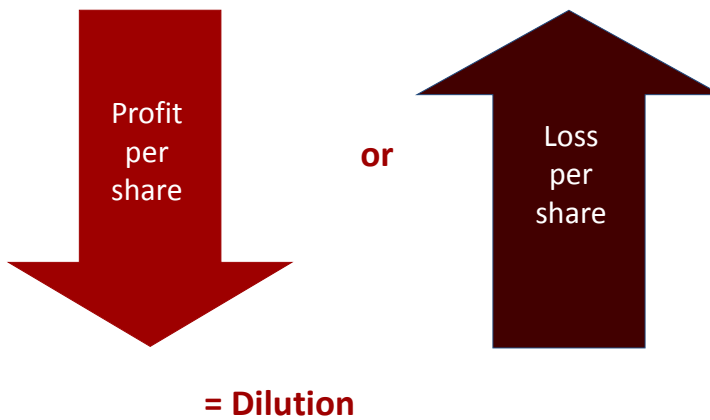
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Diluted number of shares



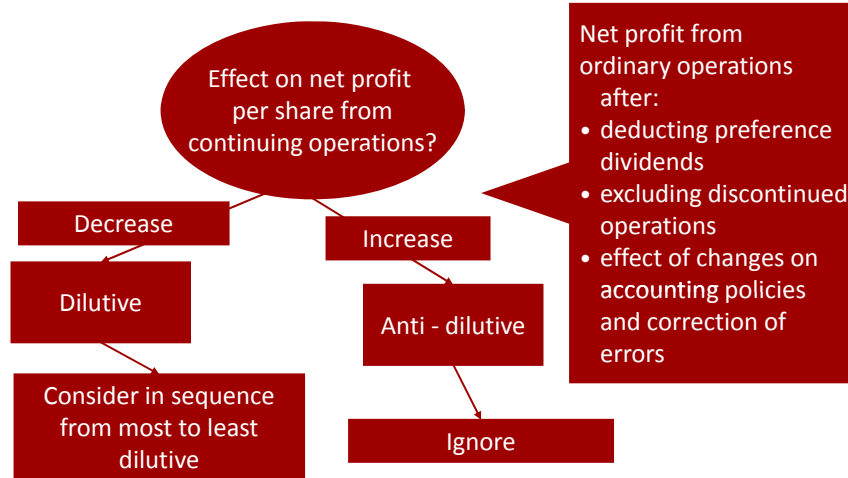
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Continuing Operations

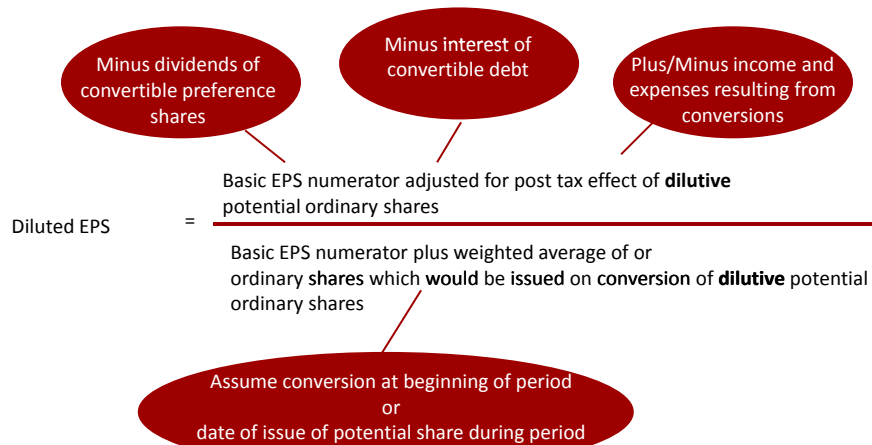


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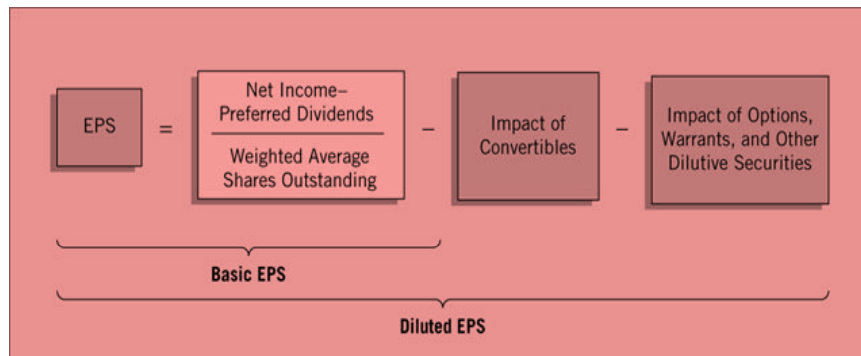
Diluted EPS issues – dilutive or anti-dilutive?



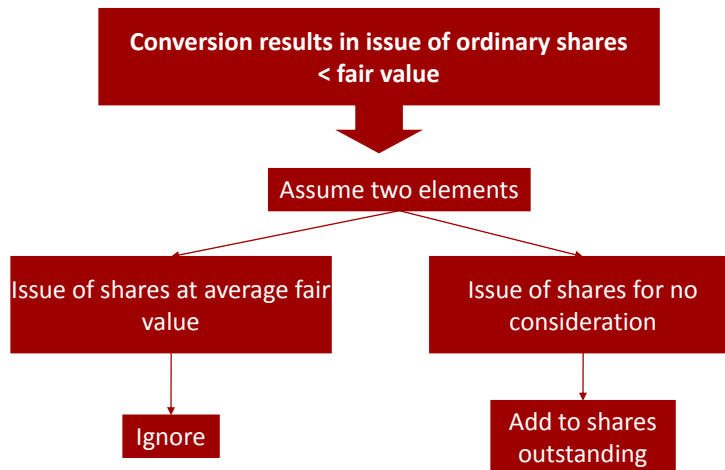
Diluted EPS- What is diluted EPS? (Contd.)



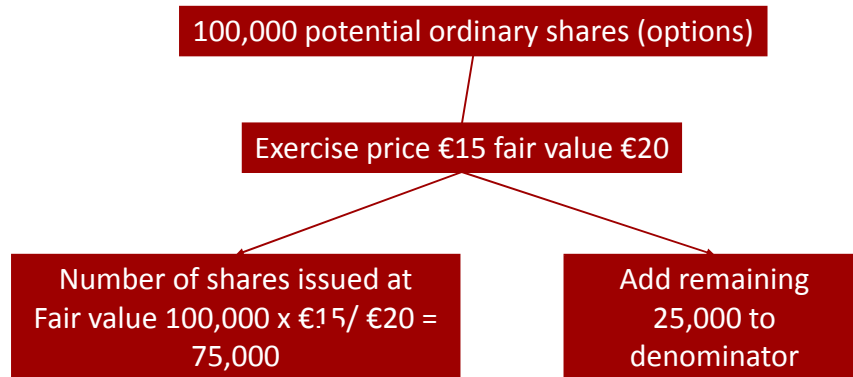
Relation between Basic and Diluted EPS



Diluted EPS issues - options and other share purchase agreements

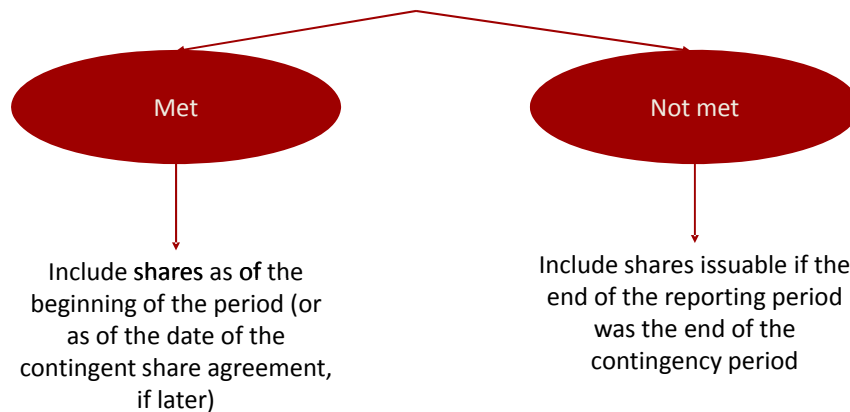


Diluted EPS issues - options and other share purchase agreements - example



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Diluted EPS issues - contingently issuable shares



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Diluted EPS - issues Group Reporting

Don't forget potential ordinary shares of entity's

Subsidiaries

Joint ventures

Associates

Include in consolidated diluted EPS if **Dilutive**

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Subsidiaries, joint ventures and associates

- A subsidiary, joint venture or associate may issue to parties other than the parent, venturer or investor, potential ordinary shares, which are convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent, venturer or investor (the reporting entity).

If these potential ordinary shares of the subsidiary, joint venture or associate have a dilutive effect on the consolidated basic earnings per share of the reporting entity, they are included in the calculation of diluted earnings per share.

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Written put options

- Written put option contracts that require the entity to repurchase its own shares are included in diluted EPS if their effect is dilutive.
- Written put options are dilutive if they are 'in-the-money'. They are in-the-money if the option exercise price > average market price of the shares in the period.
- If the options are in-the-money, the number of shares under the options that should be included in the diluted EPS is calculated as follows:
At the beginning of the period, first calculate the number of shares that could be issued at the average market price for the period to raise the necessary proceeds to satisfy the option.

The proceeds from this issue are used to satisfy the contract to buy back ordinary shares.

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Written put options (Contd.)

- The difference between the number of shares assumed to be issued at the start of the period and the number of shares bought back to satisfy the contract is included in diluted earnings per share.
- The above method is sometimes referred to as the 'reverse treasury stock method'.

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Purchased options

- Contracts such as purchased put options and purchased call options (i.e. options held by the entity on its own ordinary shares) are not included in the calculation of diluted EPS ,because including them would be antidilutive.
(Put option would be exercised only if the exercise price were higher than the market)



PRESENTATION & DISCLOSURE (Key earnings per share disclosures)

- It should be noted that EPS is calculated on "net income" and not comprehensive income, even if the figure is presented in the statement of comprehensive income.
- There are a few disclosures you need to remember with earnings per share, but the most important ones are featured below.
- Both basic and diluted EPS required to be disclosed in statement of comprehensive income.
- If shares with different rights to share of profit exists those shall be separately disclosed.
- An entity that reports a discontinued operation shall disclose the basic and diluted amounts of EPS for the discontinued operation either in the statement of comprehensive income or in the notes.



Key disclosures

- the amounts used as the earnings in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss attributable to the parent entity for the period
- the weighted average number of ordinary shares used as denominators in calculating basic and diluted earnings per share and a reconciliation of these denominators to each other
- information about instruments that could potentially dilute basic EPS in the future, but were not included because they are anti-dilutive for the period(s) presented.
- a description of ordinary share transactions or potential ordinary share transactions that occurred after the balance sheet date and that would have changed significantly the number of ordinary shares or potential ordinary shares outstanding at the end of the period if those transactions had occurred before the end of the reporting period.

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Key disclosures (Contd.)

- Entities should present in the statement of comprehensive income basic and diluted EPS for **both continuing and total operations** with equal prominence, for each class of ordinary shares. This applies even if the amounts are negative, that is a loss per share.
- Entities that report discontinued operations should present a separate EPS figures for discontinued operations in the statement of comprehensive income or in the notes.
- If an entity presents a separate income statement, it should present basic and diluted EPS for both continuing operations, discontinued operations and total operations in that statement.

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Effective date

Annual periods beginning on or after 1 January 2012.
Earlier application is encouraged, if early adopted it
shall disclose that fact

Thank you.