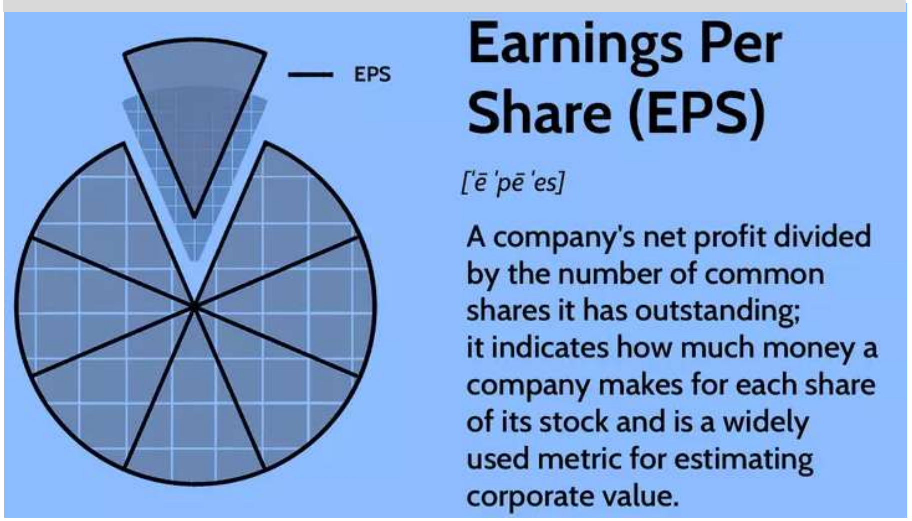
EPS (Earnings Per Share)

$$\text{EPS} = \frac{\text{Utile Netto}}{\text{Numero totale azioni } \textit{ordinarie emesse}} = \frac{2{,}0 \text{ milioni di } €}{3{,}6 \text{ milioni di azioni}} = €0{,}556 \text{ per azione}$$

$$\text{EPS} = \frac{\text{Net Income}}{\text{Number } \textit{of common shares issued}} = \frac{€2{,}0 \text{ mill}\textit{ion}}{3{,}6 \text{ million shares}} = €0{,}556 \text{ per share}$$

Earnings per share (EPS) is a company's net income subtracted by dividends and then divided by the average number of common shares outstanding. The resulting number serves as an indicator of a company's profitability. It is common for a company to report EPS that is adjusted for extraordinary items and potential share dilution.

Business English Dictionary



P/E (Price-to-Earnings Ratio)

P/E (Price-to-Earnings Ratio). Useful for evaluating whether a stock is over-or under-valued, based on the idea that the value of the stock should be proportional to the level of profits generated for shareholders.

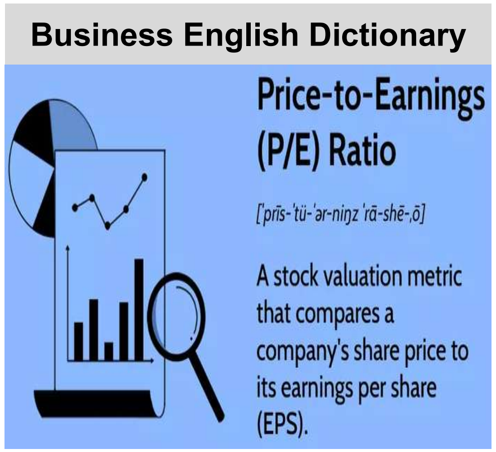
P/E is the ratio between the current value of equity and the profit made in the last twelve months:

=

Expressed on a total basis → Market capitalization ÷ Net Income

=

Expressed on a per unit basis → Share Price ÷ Earnings Per Share (EPS)



P/E (Price-to-Earnings Ratio) - How does it work? (1/2)

Il P/E va interpretato in questo modo (The P/E Ratio should be interpreted in this way):

- ✓ **P/E = 10** → The stock trades at 10 times earnings. That is to say **EPS = 10%** of the share price.

  Price share = €10.00; **Earnings per share (EPS) = €1.00**; **P/E = (10/1) = 10;**

  EPS = (1/10) = 10% of the share price.

- ✓ **P/E = 15** → The stock trades at 15 times earnings: That is to say **EPS = 6.67%** of the share price.

  Price share = €15.00; **Earnings per share (EPS) = €1.00**; **P/E = (15/1) = 15**;

  EPS = (1/15) = 6.67% of the share price.

Da questi esempi appare evidente come **la convenienza** per il potenziale investitore di un titolo **cresca al diminuire del P/E**. **Tuttavia, non bisogna fidarsi di questo indicatore** in quanto un P/E troppo basso può essere un **segnale di allarme** circa le future aspettative di mercato del titolo, mentre un P/E elevato può rappresentare un segnale di fiducia.

From these examples it is clear that the **convenience** for the potential investor of a stock **increases as the P/E decreases**. **However, you should not trust this index** as a P/E that is too low can be a **warning sign** about the future market expectations of the stock, while a high P/E can represent a signal of confidence.

P/E (Price-to-Earnings Ratio) - How does it work? (2/2)

Il P/E va interpretato in questo modo (The P/E Ratio should be interpreted in this way):

- **A value of 13-15** is **considered normal** (the price equal to 15 times the profit);
- **A value above 15** usually indicates an **overvalued stock** (it certainly is around 27-30).
- **Values around 8-9** are sought after by analysts, because they indicate **securities undervalued** by the market, which could have good growth in their prices.

- In more **traditional economic sectors**, where there is greater competition and less opportunity to achieve large profits, the price-to-earnings ratio or P/E is expected to be low.
- In **innovative sectors** or in sectors just emerging from a crisis, the expectations of high future profits push the P/E considered correct higher.

P/E (Price-to-Earnings Ratio) – To do at home

I suggest you a little job to do at home and which you will comment on in the next lesson. You can also work in groups:

To do at home

- Compare the **current P/E ratio** (Share Price ÷ Earnings Per Share, EPS, basic) **of a company (X) listed on the S&P500** (https://stockanalysis.com/list/sp-500-stocks/) with the **P/E current ratio of the S&P500** (https://www.multpl.com/s-p-500-pe-ratio).
- Also, **calculate the current P/E of a second company (Y) listed on the S&P500** (https://stockanalysis.com/list/sp-500-stocks/).
- Company X and Y must operate **in the same sector/industry** (for example: Beverages - Non-Alcoholic).
- From the comparison between company X and company Y, and with the S&P500, clarify if the company X is overvalued or undervalued. Also, indicate **what investors' expectations might be in company X** (for example: Do investors in X expect much higher future earnings growth than in Y?).