

Profits and Stocks



Earnings are a company's profits. Many businesses state their earnings as the amount of profit earned by each share of stock. This measure is called earnings per share. In order to calculate this measure of profit, you must know two things: 1) the company's total earnings for the year, and 2) the total number of shares the company has issued. For example, if a business has a total of 400,000 shares of common stock and has earnings of \$2,000,000 for the year, then its earnings per share would be computed as follows:

$$\text{Earnings per Share} = \text{Annual Earnings} / \text{Number of Shares}$$

$$\text{Earnings per Share} = \$2,000,000 / 400,000 = \$5.00$$



Question: If a company has \$1,500,000 in earnings and has 300,000 shares of stock, what are its earnings per share?

If a company's earnings per share have been rising, stockholders see this as a favorable sign. It means the business is successfully producing what consumers want. As a result, the business is earning more profit for each share of stock held by its owner.

Price-Earnings Ratio compares a stock's price to the profit each share has received. To compute the price-earnings ratio, divide the last (closing) price of the stock by the earnings per share. For example, if a stock with a closing price of \$24 has earnings per share of \$2.00, it would have a price-earnings ratio of 12.

$$\text{Price-Earnings Ratio} = \text{Stock Price} / \text{Earnings per Share}$$

$$\text{Price-Earnings Ratio} = \$24.00 / \$2.00 = 12$$



Question: What are the price-earnings ratios for a share of stock with a price of \$24.00 and earnings of \$3.00?