

Earnings per Share (IAS 33)

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1. Objective and overview of IAS 33

IAS 33 — Earnings per Share (EPS) sets out principles for the calculation and presentation of earnings per share for entities whose ordinary shares or potential ordinary shares are publicly traded. It ensures that EPS figures are calculated on a consistent basis so that performance per share can be compared across entities and periods.

EPS is a key performance indicator used by investors, analysts, and other stakeholders to assess profitability attributable to each ordinary share. IAS 33 requires both **basic EPS** and **diluted EPS** to be presented with equal prominence on the face of the statement of profit or loss and other comprehensive income.

2. Scope and key concepts

2.1 Scope of IAS 33

IAS 33 applies to:

- **Entities with publicly traded ordinary shares or potential ordinary shares**
- **Entities that voluntarily present EPS**, even if their shares are not publicly traded

In consolidated financial statements, EPS is based on **profit or loss attributable to ordinary equity holders of the parent**.

2.2 Ordinary shares and potential ordinary shares

- **Ordinary shares: Definition:** Equity instruments that are subordinate to all other classes of equity instruments. They represent residual interest in the entity after all obligations are met.
- **Potential ordinary shares: Definition:** Financial instruments or other contracts that may result in the issuance of ordinary shares (e.g. options, warrants, convertible debt, convertible preference shares, contingently issuable shares).

2.3 Basic EPS vs diluted EPS

- **Basic EPS:** Measures the amount of profit or loss attributable to each existing ordinary share.
- **Diluted EPS:** Measures the amount of profit or loss attributable to each ordinary share **assuming** that all **dilutive** potential ordinary shares had been converted into ordinary shares. Dilution is a potential reduction in EPS or a potential increase in loss per share.

3. Basic earnings per share

3.1 Core formula

Basic EPS is calculated as:

$$\text{Basic EPS} = \frac{\text{Profit or loss attributable to ordinary equity holders of the parent}}{\text{Weighted average number of ordinary shares outstanding during the period}}$$

This is the fundamental rule in IAS 33.

3.2 Numerator: earnings attributable to ordinary equity holders

Label: Profit or loss attributable

- Start with **profit or loss for the period** (after tax) from the statement of profit or loss.

Label: Adjustments for preference shares

- Deduct **dividends on preference shares** classified as equity that are attributable to the period.
- For **cumulative preference shares**, deduct the dividend for the period, **whether or not declared**.
- For **non-cumulative preference shares**, deduct only dividends declared for the period.

Label: Other equity instruments

- Deduct any other amounts attributable to instruments classified as equity that rank before ordinary shares (e.g. participating preference shares).

The resulting figure is **profit or loss attributable to ordinary equity holders of the parent**—the numerator for basic EPS.

Example 1 — Adjusting profit for preference dividends

- **Profit for the year:** R2 000 000
- **Cumulative preference shares:** R500 000 nominal, 8% dividend (equity-classified)
- **Dividend declared:** none

Because the preference shares are cumulative, the dividend for the year is still attributable:

$$\begin{aligned}\text{Preference dividend} &= \text{R500 000} \times 8\% = \text{R40 000} \\ \text{Profit attributable to ordinary equity holders} &= \text{R2 000 000} - \text{R40 000} = \text{R1 960 000}\end{aligned}$$

This R1 960 000 is the numerator for basic EPS.

3.3 Denominator: weighted average number of ordinary shares

The denominator is the **weighted average number of ordinary shares outstanding during the period**. IAS 33 requires weighting by time to reflect changes in the number of shares during the reporting period.

3.3.1 Basic principle

Label: Time-weighting

- Each tranche of shares is weighted by the fraction of the reporting period that it was outstanding.

If shares are issued or bought back during the year, the denominator is:

$$\text{Weighted average shares} = \sum (\text{Shares outstanding} \times \text{Time fraction})$$

Example 2 — Simple weighted average

Entity has:

- **1 January – 31 March (3 months):** 1 000 000 shares
- **1 April – 31 December (9 months):** 1 200 000 shares

$$\begin{aligned}\text{Weighted average} &= (1\,000\,000 \times \frac{3}{12}) + (1\,200\,000 \times \frac{9}{12}) \\ &= 250\,000 + 900\,000 = 1\,150\,000 \text{ shares}\end{aligned}$$

This 1 150 000 is the denominator for basic EPS.

3.3.2 Treatment of treasury shares

Label: Treasury shares

- Treasury shares (own shares repurchased and held) are **excluded** from the number of shares outstanding.
- When shares are repurchased, the number of outstanding shares decreases from the date of repurchase.

Example 3 — Including treasury shares

- **1 January – 30 June:** 1 000 000 shares outstanding
- **1 July:** Entity repurchases 100 000 shares as treasury shares

For the year:

- 1 January – 30 June (6 months): 1 000 000 shares

- 1 July – 31 December (6 months): 900 000 shares

$$\begin{aligned}\text{Weighted average} &= (1\,000\,000 \times \frac{6}{12}) + (900\,000 \times \frac{6}{12}) \\ &= 500\,000 + 450\,000 = 950\,000 \text{ shares}\end{aligned}$$

3.4 Bonus issues, share splits and rights issues

These events change the number of shares without a corresponding change in resources received, so IAS 33 requires special treatment to preserve comparability.

3.4.1 Capitalisation (bonus) issues and share splits

Label: Bonus issue/share split principle

- A **bonus issue** (capitalisation issue) or **share split** increases the number of shares without increasing equity.
- For EPS, treat as if the new shares had been issued **at the beginning of the earliest period presented**.
- Restate **all comparative EPS figures** accordingly.

Example 4 — Bonus issue

Entity has:

- **Before bonus issue:** 1 000 000 shares
- **Bonus issue:** 1 new share for every 4 existing shares (1-for-4)

New total shares:

$$\text{New shares} = 1\,000\,000 + \frac{1\,000\,000}{4} = 1\,250\,000$$

For EPS:

- Use 1 250 000 shares for the current year denominator.
- Restate prior-year EPS using 1 250 000 shares as if they existed throughout the prior year.

3.4.2 Rights issues

Rights issues are more complex because they combine a capital raising with a bonus element (shares issued at a discount to market price). IAS 33 requires an **adjustment factor** to reflect the bonus element.

Label: Rights issue adjustment factor:

$$\text{Adjustment factor} = \frac{\text{Fair value per share immediately before the exercise of rights}}{\text{Theoretical ex-rights price per share}}$$

This factor is applied to:

- The number of shares **before** the rights issue for the current period; and
- All **comparative EPS figures**.

Example 5 — Rights issue

Entity has:

- **Shares before rights issue:** 1 000 000
- **Rights issue:** 1 new share for every 5 existing shares at R8 per share
- **Market price before rights issue:** R10 per share

Step 1: Theoretical ex-rights price (TERP)

Total value of shares after rights issue:

$$\text{Value existing shares} = 1\,000\,000 \times R10 = R10\,000\,000$$

New shares:

$$\text{New shares} = \frac{1\,000\,000}{5} = 200\,000$$

$$\text{Value of new shares} = 200\,000 \times R8 = R1\,600\,000$$

Total shares after rights issue:

$$\text{Total shares} = 1\,000\,000 + 200\,000 = 1\,200\,000$$

$$\text{TERP} = \frac{R10\,000\,000 + R1\,600\,000}{1\,200\,000} = \frac{R11\,600\,000}{1\,200\,000} = R9.67 \text{ (approx.)}$$

Step 2: Adjustment factor

$$\text{Adjustment factor} = \frac{R10}{R9.67} \approx 1.034$$

For EPS:

- Multiply the **pre-rights issue shares** by 1.034 when computing the weighted average for the current year.
- Restate prior-year EPS using the adjusted number of shares.

4. Diluted earnings per share

4.1 Core formula

Diluted EPS reflects the potential dilution from instruments that could convert into ordinary shares. The formula is:

$$\text{Diluted EPS} = \frac{\text{Adjusted profit or loss attributable to ordinary equity holders}}{\text{Weighted average number of ordinary shares + effect of dilutive potential ordinary shares}}$$

The numerator and denominator are adjusted for the assumed conversion of **dilutive** potential ordinary shares.

4.2 Dilutive vs anti-dilutive instruments

Label: Dilutive instruments

- A potential ordinary share is **dilutive** if its assumed conversion **reduces EPS** (or increases loss per share).

Label: Anti-dilutive instruments

- If assumed conversion **increases EPS** (or reduces loss per share), the instrument is **anti-dilutive** and must be **excluded** from diluted EPS.

IAS 33 requires that only **dilutive** instruments be included in the diluted EPS calculation.

4.3 Adjusting the numerator

When potential ordinary shares are assumed to be converted:

- **Add back** any **interest (net of tax)** or **dividends** that would no longer be incurred if the instrument were converted.
- Adjust for any other income or expense effects of conversion.

Examples:

- Preference shares recognised as liabilities: add back **interest expense (net of tax)**.
- Preference shares recognised as equity: add back **preference dividends**.

4.4 Adjusting the denominator

The denominator is increased by the number of ordinary shares that would be issued on conversion of dilutive instruments:

- **Convertible debt or preference shares:** add the number of shares that would be issued on conversion.
- **Options and warrants:** use the **treasury shares method**.
- **Contingently issuable shares:** include only if conditions are met at reporting date (or partially met, depending on terms).

5. Specific types of potential ordinary shares

5.1 Options and warrants — treasury shares (or treasury stock) method

For options and warrants, IAS 33 uses the **treasury stock method**:

Label: Treasury stock method steps:

1. **Assume all options/warrants are exercised** at the beginning of the period (or date of issue, if later).
2. **Assume the entity uses the proceeds** from exercise to **repurchase shares** at the **average market price** during the period.
3. The **net increase in shares** (shares issued minus shares repurchased) is added to the denominator.

If the exercise price is **higher** than the average market price, the options are **anti-dilutive** and excluded.

Example 6 — Options

Entity has:

- **Profit attributable to ordinary equity holders:** R3 000 000
- **Weighted average shares (basic):** 1 000 000
- **Share options outstanding:** 100 000 options, exercise price R20
- **Average market price during the year:** R25

Step 1: Basic EPS

$$\text{Basic EPS} = \frac{\text{R3 000 000}}{1\,000\,000} = \text{R3.00 per share}$$

Step 2: Treasury stock method

Assume all 100 000 options are exercised:

- **Proceeds:**

$$\text{Proceeds} = 100\,000 \times \text{R20} = \text{R2 000 000}$$

- **Shares that could be repurchased at average market price:**

$$\text{Shares repurchased} = \frac{\text{R2 000 000}}{\text{R25}} = 80\,000 \text{ shares}$$

- Net increase in shares:

$$\text{Net shares} = 100\,000 - 80\,000 = 20\,000 \text{ shares}$$

Step 3: Diluted EPS

Denominator:

$$\text{Diluted shares} = 1\,000\,000 + 20\,000 = 1\,020\,000$$

Numerator unchanged (no interest/dividends to add back):

$$\text{Diluted EPS} = \frac{\text{R3 000 000}}{1\,020\,000} \approx \text{R2.94 per share}$$

Since diluted EPS (R2.94) is lower than basic EPS (R3.00), the options are **dilutive** and included.

5.2 Convertible bonds — if-converted method

For convertible bonds:

Label: If-converted method steps:

1. Assume the bonds are **converted into ordinary shares** at the beginning of the period (or date of issue, if later).
2. **Add back the interest expense (net of tax)** to the numerator.
3. **Add** the number of shares that would be issued on conversion to the denominator.

Example 7 — Convertible bond

Entity has:

- **Profit attributable to ordinary equity holders (after interest):** R4 000 000
- **Convertible bond:**
 - Nominal value: R1 000 000
 - Interest rate: 10%
 - Tax rate: 28%
 - Each R100 bond is convertible into 5 ordinary shares
- **Weighted average shares (basic):** 2 000 000

Step 1: Interest to add back

Annual interest:

$$\text{Interest} = \text{R1 000 000} \times 10\% = \text{R100 000}$$

Tax effect:

$$\text{Tax saving} = \text{R100 000} \times 28\% = \text{R28 000}$$

Interest net of tax:

$$\text{Interest (net)} = \text{R100 000} - \text{R28 000} = \text{R72 000}$$

Adjusted numerator:

$$\text{Adjusted profit} = \text{R4 000 000} + \text{R72 000} = \text{R4 072 000}$$

Step 2: Shares from conversion

Number of bonds:

$$\text{Number of bonds} = \frac{\text{R1 000 000}}{\text{R100}} = 10\,000$$

Shares per bond: 5

$$\text{Shares on conversion} = 10\,000 \times 5 = 50\,000 \text{ shares}$$

Denominator:

$$\text{Diluted shares} = 2\,000\,000 + 50\,000 = 2\,050\,000$$

Step 3: Diluted EPS

$$\text{Diluted EPS} = \frac{\text{R4 072 000}}{2\,050\,000} \approx \text{R1.99 per share}$$

Compare with basic EPS:

$$\text{Basic EPS} = \frac{\text{R4 000 000}}{2\,000\,000} = \text{R2.00 per share}$$

Since diluted EPS (R1.99) is slightly lower than basic EPS (R2.00), the convertible bond is **dilutive** and included.

5.3 Contingently issuable shares

Contingently issuable shares are ordinary shares that are issuable only if certain conditions are met (e.g. achieving a profit target, share price target, or service period).

Label: Treatment in basic EPS:

- Include contingently issuable shares in **basic EPS** only from the date when **all conditions are satisfied**.

Label: Treatment in diluted EPS

- For **diluted EPS**, include contingently issuable shares **as if the conditions were satisfied at the beginning of the period**, if they are **currently satisfied** at reporting date.
- If conditions are **partially satisfied**, include the number of shares that would be issuable if the reporting date were the end of the contingency period (depending on the arrangement).

Example 8 — Profit-based contingently issuable shares

Entity agrees to issue 100 000 shares to management if **cumulative profit** over three years exceeds R10 000 000.

- At the end of Year 2, cumulative profit is R7 000 000.
- At the end of Year 3, cumulative profit is R11 000 000 (condition met).

Year 2:

- **Basic EPS:** No contingently issuable shares included (condition not met).
- **Diluted EPS:** If the arrangement is such that partial progress does not trigger any shares, no shares are included.

Year 3:

- **Basic EPS:** Include 100 000 shares from the date the condition is met (if mid-year, time-weighted).
- **Diluted EPS:** Assume the 100 000 shares were outstanding from the beginning of Year 3.

5.4 Contracts that may be settled in shares or cash

Some contracts allow the entity or the holder to choose settlement in **cash** or **shares**.

Label: Settlement choice by entity

- If the entity has the choice, IAS 33 presumes **share settlement** if it is more dilutive.

Label: Settlement choice by holder

- If the holder has the choice, assume **share settlement** if it is more dilutive.

The number of shares that would be issued under share settlement is included in the denominator for diluted EPS, and the numerator is adjusted for any related income/expense effects.

6. Presentation and disclosure

6.1 Presentation requirements

IAS 33 requires:

- **Basic EPS** and **diluted EPS** to be presented on the face of the statement of profit or loss and other comprehensive income.
- EPS must be shown **with equal prominence** for:
 - **Total profit or loss**
 - **Profit or loss from continuing operations** (if presented)
 - **Discontinued operations**, either on the face or in the notes.

6.2 Disclosure requirements

Entities must disclose:

- **Label:** Numerator reconciliation
 - The amounts used as the numerators in calculating basic and diluted EPS.
 - A reconciliation of these amounts to **profit or loss** for the period.
- **Label:** Denominator reconciliation
 - The weighted average number of ordinary shares used as the denominator in calculating basic and diluted EPS.
 - A reconciliation of these denominators to each other.
- **Label:** Potential dilution
 - A description of instruments (including contingently issuable shares) that could potentially dilute basic EPS in the future but were **not included** in the diluted EPS calculation because they were anti-dilutive or conditions were not yet met.
- **Label:** Post-reporting date share transactions
 - A description of ordinary share transactions after the reporting period that would have significantly changed EPS if they had occurred before the end of the reporting period (e.g. major share issues, buybacks, splits, or rights issues).

6.3 Restatement of EPS

IAS 33 requires restatement of EPS for:

- **Bonus (capitalisation) issues**
- **Share splits**
- **Rights issues** (using the adjustment factor)

All **comparative EPS figures** must be restated as if the new number of shares had been in issue for all periods presented.

7. Common pitfalls and exam focus areas

7.1 Numerator mistakes

- **Forgetting preference dividends** (especially cumulative preference shares).
- Not adjusting for **interest (net of tax)** on convertible debt in diluted EPS.
- Ignoring **participating equity instruments** that share in profit with ordinary shares.

7.2 Denominator mistakes

- **Not time-weighting** share issues and buybacks.
- Including **treasury shares** in the denominator.
- Failing to adjust for **bonus issues** and **rights issues** in both current and comparative EPS.

7.3 Dilution errors

- Including **anti-dilutive** instruments in diluted EPS.
- Misapplying the **treasury stock method** for options and warrants.
- Forgetting to include **contingently issuable shares** in diluted EPS when conditions are met at reporting date.

7.4 Presentation and disclosure

- Omitting EPS for **continuing operations** and **discontinued operations** when required.
- Not providing **reconciliations** of numerators and denominators.
- Failing to disclose **potentially dilutive instruments** that were not included in diluted EPS.

8. Integrated worked example

Below is a combined example that brings together basic and diluted EPS concepts.

8.1 Scenario

Entity Alpha reports the following for the year ended 31 December 20X5:

- **Profit for the year:** R5 000 000
- **Cumulative preference shares (equity):**
 - Nominal value: R1 000 000
 - Dividend rate: 6%
 - No dividend declared
- **Ordinary shares:**
 - 1 January: 2 000 000 shares
 - 1 April: issued 500 000 shares for cash
 - No treasury shares

- **Share options:**
 - 200 000 options outstanding all year
 - Exercise price: R15
 - Average market price during the year: R20
- **Convertible bond:**
 - Nominal value: R2 000 000
 - Interest rate: 9%
 - Tax rate: 28%
 - Each R100 bond convertible into 4 ordinary shares

8.2 Step 1 — Basic EPS

Label: Numerator

Preference dividend (cumulative):

$$\text{Preference dividend} = \text{R1 000 000} \times 6\% = \text{R60 000}$$

Profit attributable to ordinary equity holders:

$$\text{Profit attributable} = \text{R5 000 000} - \text{R60 000} = \text{R4 940 000}$$

Label: Denominator — weighted average shares

- 1 January – 31 March (3 months): 2 000 000 shares
- 1 April – 31 December (9 months): 2 500 000 shares

$$\begin{aligned} \text{Weighted average} &= \left(2\,000\,000 \times \frac{3}{12}\right) + \left(2\,500\,000 \times \frac{9}{12}\right) \\ &= 500\,000 + 1\,875\,000 = 2\,375\,000 \text{ shares} \end{aligned}$$

Label: Basic EPS

$$\text{Basic EPS} = \frac{\text{R4 940 000}}{2\,375\,000} \approx \text{R2.08 per share}$$

8.3 Step 2 — Diluted EPS: options (treasury stock method)

Label: Options

- Options: 200 000
- Exercise price: R15
- Average market price: R20

Proceeds if exercised:

$$\text{Proceeds} = 200\,000 \times \text{R15} = \text{R3 000 000}$$

Shares that could be repurchased:

$$\text{Shares repurchased} = \frac{\text{R3 000 000}}{\text{R20}} = 150\,000 \text{ shares}$$

Net increase in shares:

$$\text{Net shares} = 200\,000 - 150\,000 = 50\,000 \text{ shares}$$

8.4 Step 3 — Diluted EPS: convertible bond (if-converted)

Label: Convertible bond

Interest:

$$\text{Interest} = \text{R2 000 000} \times 9\% = \text{R180 000}$$

Tax effect:

$$\text{Tax saving} = \text{R180 000} \times 28\% = \text{R50 400}$$

Interest net of tax:

$$\text{Interest (net)} = \text{R180 000} - \text{R50 400} = \text{R129 600}$$

Adjusted numerator:

$$\text{Adjusted profit} = \text{R4 940 000} + \text{R129 600} = \text{R5 069 600}$$

Shares from conversion:

Number of bonds:

$$\text{Number of bonds} = \frac{\text{R2 000 000}}{\text{R100}} = 20\,000$$

Shares per bond: 4

$$\text{Shares on conversion} = 20\,000 \times 4 = 80\,000 \text{ shares}$$

8.5 Step 4 — Diluted EPS calculation

Label: Denominator for diluted EPS

Start with basic denominator:

$$2\,375\,000 \text{ shares}$$

Add net shares from options:

$$+50\,000 = 2\,425\,000$$

Add shares from convertible bond:

$$+80\,000 = 2\,505\,000 \text{ shares}$$

Label: Diluted EPS

$$\text{Diluted EPS} = \frac{\text{R}5\,069\,600}{2\,505\,000} \approx \text{R}2.02 \text{ per share}$$

Label: Comparison

- **Basic EPS:** R2.08 per share
- **Diluted EPS:** R2.02 per share

Since diluted EPS is lower, both the options and the convertible bond are **dilutive** and correctly included.

9. Exam-Style Question Bank (with full memos)

QUESTION 1 — Basic EPS with Share Issue Mid-Year

Scenario:

Metsi Ltd reports the following for the year ended 31 December 20X5:

- Profit for the year: **R3 600 000**
- Cumulative preference shares (equity):
 - Nominal value: **R500 000**
 - Dividend rate: **10%**
 - No dividend declared
- Ordinary shares:
 - 1 January: **1 200 000 shares**
 - 1 July: Issued **300 000 shares** for cash

Required: Calculate **Basic EPS** for 20X5.

MEMO — Solution

Step 1: Preference dividend

$$\text{R}500\,000 \times 10\% = \text{R}50\,000$$

Profit attributable to ordinary equity holders:

$$R3\ 600\ 000 - R50\ 000 = R3\ 550\ 000$$

Step 2: Weighted average number of shares

- 1 Jan – 30 Jun (6 months): 1 200 000
- 1 Jul – 31 Dec (6 months): 1 500 000

$$1\ 200\ 000 \times \frac{6}{12} = 600\ 000$$

$$1\ 500\ 000 \times \frac{6}{12} = 750\ 000$$

$$\text{Weighted average} = 600\ 000 + 750\ 000 = 1\ 350\ 000$$

Step 3: Basic EPS

$$\text{Basic EPS} = \frac{R3\ 550\ 000}{1\ 350\ 000} = R2.63 \text{ per share}$$

QUESTION 2 — Diluted EPS with Options (Treasury Stock Method)

Scenario:

Thabisa Ltd has:

- Profit attributable to ordinary equity holders: **R4 200 000**
- Weighted average ordinary shares (basic): **2 000 000**
- Share options outstanding:
 - **300 000 options**
 - Exercise price: **R12**
 - Average market price: **R15**

Required: Calculate **Diluted EPS**.

MEMO — Solution

Step 1: Treasury stock method

Proceeds if exercised:

$$300\ 000 \times R12 = R3\ 600\ 000$$

Shares repurchased at average market price:

$$\frac{\text{R3 600 000}}{\text{R15}} = 240\,000$$

Net increase in shares:

$$300\,000 - 240\,000 = 60\,000$$

Step 2: Diluted denominator

$$2\,000\,000 + 60\,000 = 2\,060\,000$$

Step 3: Diluted EPS

$$\frac{\text{R4 200 000}}{2\,060\,000} = \text{R2.04 per share}$$

QUESTION 3 — Convertible Bond (If-Converted Method)

Scenario:

Kopano Ltd has:

- Profit attributable to ordinary equity holders (after interest): **R5 500 000**
- Convertible bond:
 - Nominal value: **R3 000 000**
 - Interest rate: **8%**
 - Tax rate: **28%**
 - Each R100 bond converts into **3 shares**
- Weighted average ordinary shares (basic): **2 500 000**

Required: Calculate **Diluted EPS**.

MEMO — Solution

Step 1: Add back interest (net of tax)

Interest:

$$\text{R3 000 000} \times 8\% = \text{R240 000}$$

Tax saving:

$$\text{R240 000} \times 28\% = \text{R67 200}$$

Interest net of tax:

$$R240\,000 - R67\,200 = R172\,800$$

Adjusted numerator:

$$R5\,500\,000 + R172\,800 = R5\,672\,800$$

Step 2: Shares from conversion

Number of bonds:

$$\frac{R3\,000\,000}{R100} = 30\,000$$

Shares issued:

$$30\,000 \times 3 = 90\,000$$

Step 3: Diluted denominator

$$2\,500\,000 + 90\,000 = 2\,590\,000$$

Step 4: Diluted EPS

$$\frac{R5\,672\,800}{2\,590\,000} = R2.19 \text{ per share}$$

QUESTION 4 — Rights Issue (Adjustment Factor)

Scenario:

On 1 September 20X5, Langa Ltd makes a rights issue:

- Shares before rights issue: **1 000 000**
- Rights issue: **1 share for every 4 shares** at **R8**
- Market price before rights issue: **R10**
- Profit attributable to ordinary equity holders: **R6 000 000**

Required: Calculate the **adjustment factor** and the **restated weighted average shares** for EPS.

MEMO — Solution

Step 1: TERP (Theoretical ex-rights price)

Value of existing shares:

$$1\,000\,000 \times R10 = R10\,000\,000$$

New shares:

$$\frac{1\,000\,000}{4} = 250\,000$$

Value of new shares:

$$250\,000 \times R8 = R2\,000\,000$$

Total shares:

$$1\,000\,000 + 250\,000 = 1\,250\,000$$

TERP:

$$\frac{R12\,000\,000}{1\,250\,000} = R9.60$$

Step 2: Adjustment factor

$$\frac{R10}{R9.60} = 1.0417$$

Step 3: Restated shares

Pre-rights shares $\times$ adjustment factor:

$$1\,000\,000 \times 1.0417 = 1\,041\,700$$

Add new shares (from 1 September):

Time-weighting (4 months):

$$250\,000 \times \frac{4}{12} = 83\,333$$

Total weighted average shares:

$$1\,041\,700 + 83\,333 = 1\,125\,033$$

QUESTION 5 — Contingently Issuable Shares

Scenario:

Sindi Ltd agrees to issue **150 000 shares** to management if profit for 20X5 exceeds **R10 000 000**.

- Actual profit for 20X5: **R11 200 000**
- Condition met on **31 October 20X5**
- Ordinary shares outstanding all year: **2 000 000**

Required: Explain and calculate the treatment of contingently issuable shares for **Basic** and **Diluted EPS**.

MEMO — Solution

Basic EPS

Include contingently issuable shares **from the date the condition is met:**

Time-weighting (Nov–Dec = 2 months):

$$150\,000 \times \frac{2}{12} = 25\,000$$

Basic denominator:

$$2\,000\,000 + 25\,000 = 2\,025\,000$$

Diluted EPS

Include **as if** the shares were outstanding **from the beginning of the year:**

$$2\,000\,000 + 150\,000 = 2\,150\,000$$

10. Integrated Exam Case Study (Full Scenario + Memo)

Total Marks: 100

Currency: Rand (R)

BACKGROUND INFORMATION:

You are provided with the following information for **Imbokodo Ltd** for the year ended **31 December 20X5**.

The entity has a complex capital structure including ordinary shares, cumulative preference shares, share options, convertible debt, a rights issue, treasury shares, and a profit-based contingent share arrangement.

Unless otherwise stated, assume all transactions occur at the start of the day.

SECTION A — FINANCIAL PERFORMANCE

1. Profit for the year

- Profit (after tax): **R12 800 000**

2. Cumulative preference shares (recognised as equity)

- Nominal value: **R2 000 000**
- Dividend rate: **7%**
- No preference dividend declared during 20X5.

SECTION B — ORDINARY SHARE MOVEMENTS

1. Shares outstanding

- **1 January 20X5:** 5 000 000 ordinary shares
- **1 March 20X5:** Rights issue (details in Section C)
- **1 July 20X5:** Entity repurchases **200 000 shares** as treasury shares
- **1 October 20X5:** Issued **400 000 shares** for cash at market price

The treasury shares are held throughout the remainder of the year.

SECTION C — RIGHTS ISSUE (1 March 20X5)

- Rights issue: **1 share for every 5 shares held**
- Subscription price: **R10**
- Market price before rights issue: **R12**

SECTION D — POTENTIAL ORDINARY SHARES

1. Share options (treasury stock method)

- Options outstanding all year: **600 000**
- Exercise price: **R15**
- Average market price during the year: **R20**

2. Convertible bond (if-converted method)

- Nominal value: **R5 000 000**
- Interest rate: **9%**
- Tax rate: **28%**
- Each R100 bond converts into **4 ordinary shares**

3. Contingently issuable shares

Management will receive **300 000 shares** if profit exceeds **R12 000 000**.

- Condition met on **31 December 20X5**.

REQUIRED:

1. Calculate the **Basic EPS** for Imbokodo Ltd for 20X5. *(40 marks)*
2. Calculate the **Diluted EPS** for Imbokodo Ltd for 20X5. *(60 marks)*

(TOTAL: 100 marks)

MEMO — FULL SOLUTION

PART 1 — BASIC EPS (40 marks)

Step 1: Adjusted profit (numerator)

Preference dividend (cumulative):

$$R2\,000\,000 \times 7\% = R140\,000$$

Profit attributable to ordinary shareholders:

$$R12\,800\,000 - R140\,000 = R12\,660\,000$$

Step 2: Rights issue adjustment factor

TERP (Theoretical ex-rights price)

Value of existing shares:

$$5\,000\,000 \times R12 = R60\,000\,000$$

New shares:

$$\frac{5\,000\,000}{5} = 1\,000\,000$$

Value of new shares:

$$1\,000\,000 \times R10 = R10\,000\,000$$

Total shares:

$$5\,000\,000 + 1\,000\,000 = 6\,000\,000$$

TERP:

$$\frac{R70\,000\,000}{6\,000\,000} = R11.67$$

Adjustment factor

$$\frac{R12}{R11.67} = 1.0283$$

Step 3: Weighted average shares

1 Jan – 28 Feb (2 months)

Shares before rights issue adjusted:

$$5\,000\,000 \times 1.0283 = 5\,141\,500$$

Weighted:

$$5\,141\,500 \times \frac{2}{12} = 856\,917$$

1 Mar – 30 Jun (4 months)

Shares after rights issue:

6 000 000 shares

Weighted:

$$6\,000\,000 \times \frac{4}{12} = 2\,000\,000$$

1 Jul – 30 Sep (3 months)

Treasury shares repurchased:

$$6\,000\,000 - 200\,000 = 5\,800\,000$$

Weighted:

$$5\,800\,000 \times \frac{3}{12} = 1\,450\,000$$

1 Oct – 31 Dec (3 months)

New shares issued:

$$5\,800\,000 + 400\,000 = 6\,200\,000$$

Weighted:

$$6\,200\,000 \times \frac{3}{12} = 1\,550\,000$$

Total weighted average shares

$$856\,917 + 2\,000\,000 + 1\,450\,000 + 1\,550\,000 = 5\,856\,917$$

Step 4: Basic EPS

$$\text{Basic EPS} = \frac{\text{R}12\,660\,000}{5\,856\,917} = \text{R}2.16 \text{ per share}$$

PART 2 — DILUTED EPS (60 marks)

Start with:

- Adjusted profit: **R12 660 000**
- Basic denominator: **5 856 917 shares**

Now incorporate dilutive instruments.

A. Share Options (Treasury Shares Method)

Step 1: Proceeds

$$600\,000 \times R15 = R9\,000\,000$$

Step 2: Shares repurchased

$$\frac{R9\,000\,000}{R20} = 450\,000$$

Step 3: Net increase

$$600\,000 - 450\,000 = 150\,000$$

Add to denominator:

$$5\,856\,917 + 150\,000 = 6\,006\,917$$

B. Convertible Bond (If-Converted Method)

Step 1: Add back interest (net of tax)

Interest:

$$R5\,000\,000 \times 9\% = R450\,000$$

Tax saving:

$$R450\,000 \times 28\% = R126\,000$$

Interest net of tax:

$$R450\,000 - R126\,000 = R324\,000$$

Adjusted numerator:

$$R12\,660\,000 + R324\,000 = R12\,984\,000$$

Step 2: Shares from conversion

Number of bonds:

$$\frac{\text{R5 000 000}}{100} = 50\,000$$

Shares issued:

$$50\,000 \times 4 = 200\,000$$

Add to denominator:

$$6\,006\,917 + 200\,000 = 6\,206\,917$$

C. Contingently Issuable Shares

Condition met at year-end → include **full 300 000 shares** in diluted EPS.

$$6\,206\,917 + 300\,000 = 6\,506\,917$$

Final Diluted EPS:

$$\text{Diluted EPS} = \frac{\text{R12 984 000}}{6\,506\,917} = \text{R1.99 per share}$$

FINAL RESULTS:

<u>EPS Type</u>	<u>Amount</u>
Basic EPS	R2.16
Diluted EPS	R1.99
