How To Evaluate a Stock Before Investing: 10 Stock Performance Indicatorsaa

As a beginner investor, how do you analyze a stock before buying it? What performance indicators should you use to assessand value a stock (equity) before investing in it? I answer this question here as a part of my INVESTING 101 series.

Investing in individual stocks and building a diversified portfolio can be challenging for a new investor.

I use the term “diversified” because you want to hold a basket of assets that includes a variety of investment products andwhich lowers your overall risk, compared to holding a single-asset portfolio.

It is easier to meet your portfolio diversification needs by holding one or a few globally diversified equity mutual funds or ETFs.

However, if you are venturing into the world of individual stocks, it is important you knowsome of the basic stock performanceindicators below and understand what they mean.

1. Earnings Per Share (EPS)

This is a measure of profitability and shows how much money a company has earned for each of its outstanding commonshares. It’s calculated as:

> EPS = (Net Income – Preferred Dividends) ÷ Outstanding Common Shares

For example, Company XYZ has a net income of $100,000 and a total of 10,000 outstanding shares. If it pays its preferredshareholders a total dividend of $25,000, its EPS is:

> $(100,000 – 25,000)/10,000 = $75,000 / 10,000 = $7.5 per share

The more profitable a company is, the higher its EPS. Higher earnings can show investorsthat a company will be able to paymore dividends now and in the future.

Analysts are often gung-ho about the EPS of a company, as they also use the information to compute its P/E and PEG ratios.

EPS can also be calculated as “diluted” EPS in which case all convertible securities and shares (convertible preferred shares,bond and stock options, and warrants) are taken into consideration in arriving at the total number of shares used in thedenominator.

As with all other stock valuation indicators, EPS should not be looked at in isolation and has some limitations:

- EPS does not consider how much debt a company holds and its return on equity.
- Earnings figures are only useful when they are accurate. If a company manipulates its earnings, the EPS is useless.
- Companies can improve their EPS by buying back some of their shares.

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