Stock Share Prices

One of the most common questions asked at my office involves stock share price. A basic discussion below should provide investors with a fundamental understanding of a company’s share price, what determines it, and what a stock split means for investors.

Market Capitalization, or market cap, refers to the total value of a company. This is determined by taking the total amount of shares outstanding and multiplying by the price per share. For example, Company A has 10,000 shares outstanding with a market price of $15/share. The total value of Company A is $150,000. Large companies such as Exxon Mobil, Apple, and Wal-mart have a market cap worth tens of *billions* of dollars.

The value of a company is determined by many factors such as earnings, earnings growth, dividend yield and risks associated with the company. Quarterly, a company will report how much it earned in profits in the previous quarter. The relation between the earnings a company makes and its market cap is important. Earnings per share, or EPS, are reported to tell investors how much profit a company made per share. EPS is determined by dividing earnings of a company into the total number of shares outstanding. All else remaining equal, would you rather own a company with EPS of $5/share and a stock price of $50, or a company that reported EPS of $1/share with a share price of $25/share?

Traders and stock analysis estimate how much a company will earn. A difference of actual EPS versus estimated EPS can send the company’s stock soaring or plummeting. Even a penny difference in actual EPS versus what was estimated can mean a lot of money once you multiply that penny deviation over millions or even billions of outstanding shares.

A company’s board of directors can declare a stock split. A common stock split is a 2 for 1 where existing share owners receive one additional share for each existing share they currently have. For example, an owner of 100 shares of XYZ stock currently valued at $40 per share, post-split would own 200 shares of XYZ with a price of $20 per share. The total value of ownership did not change due to a stock split. The market cap of the company is unaffected due to a stock split since the number of shares doubles but the value per share drops in half. The size of the pie didn’t change, however, there are now twice as many pieces of pie and the slices are half as big!

Low priced shares of a company are not necessarily better or worse than high priced shares of another company. A basic understanding of share prices and the elements that effect share price are important for an investor to understand.

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