Stanley Department Stores reported net income of $720,000 for the year ended December 31, 2021.

Additional Information:
- Common shares outstanding at January 1, 2021 = 80,000
- Incentive stock options (vested in 2020) outstanding throughout 2021 = 24,000
  
  (Each option is exercisable for one common share at an exercise price of $37.50)
  
  During the year, the market price of Stanley’s common stock averaged $45 per share
  
  On August 30, Stanley sold 15,000 common shares

Stanley’s only debt consisted of $50,000 of 10% short term bank notes. The company’s income tax rate is 25%.

Compute Stanley’s basic and diluted earnings per share for the year ended December 31, 2021.

Exercise 19-20 (continued)

Numerator (Basic EPS): Net income = $720,000; Preferred dividends = $0

Denominator (Basic EPS): Weighted average # shares of common stock outstanding

\[
\begin{align*}
1/1 - 12/31 & \quad 80,000 \times (12/12) = 80,000 \\
8/31 - 12/31 & \quad 15,000 \times (4/12) = 5,000 \\
\text{Weighted average # shares} & \quad 85,000
\end{align*}
\]

Basic EPS = $720,000 ÷ 85,000 = $8.47

Exercise 19-20 (continued)

Exercisable Securities, Stock Options
Are they dilutive? Yes because the exercise price of $37.50/share < the average market price of $45/share.

Use the Treasury Stock Method

1. Exercise is assumed to take place at the later of the date of issue (2020) or the beginning of the year (1/1/21). Assume exercise 1/1/21.

2. The Treasury Stock Method assumes that the proceeds received upon exercise of $900,000 (24,000 x $37.50) are used to buy back stock at the average market price, i.e., $900,000 ÷ $45 = 20,000

3. The net increase in the number of shares = 4,000 (24,000 issued upon exercise – 20,000 repurchased)

Diluted EPS = $720,000 ÷ (85,000 + 4,000) = $8.09