SilverOak
WEALTH MANAGEMENT LLC

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Stock Splits Explained

Stock splits have become a popular topic this year, with a number of high profile announcements such as Apple's 4-for-1 split and Tesla's 5-for-1. Not only have the announcements garnered attention due to the fact that these are some of the largest public U.S. companies, but both stocks proceeded to rise 30%+ post-split announcement.

A stock split does not change the value of a company, rather the price per share is lowered while more shares are issued to investors. The pizza does not grow, but is cut into more slices. Dividends per share are also reduced but the value of the dividend remains the same. Below is an example of a 2-for-1 split:

Company XZY	Pre-split	Post-Split
Market Value	$10,000	$10,000
# of Shares	100	200
Price per share	$100	$50
Dividend per share	$2	$1

If the value of a company does not change due to a stock split, then why do companies engage in them? Historically, companies may choose to lower the price of their shares in order to attract more investors or change the investor base. By lowering the price per share, more retail investors are able to purchase shares, opening up the investment to a base that may not have been inclined to purchase shares at a higher price. This may be less of a concern going forward as many brokerage firms now enable investors to purchase fractional shares. However, it would still make it cheaper to trade options following a stock split and potentially increase liquidity in the stock.

The math shows us that the value of a company does not directly change because of a stock split. However, in practice, stock splits may have an impact on investor psychology and behavior. For instance, a lower stock price may feel more enticing for investors and result in an increase in demand for the stock. Corporate management may see a stock split as a signal of confidence to investors that the company's fundamentals are strong.

There have been many studies on stock splits, and while the data is inconclusive as to whether companies directly benefit from stock splits, the data does show that stocks that have split tend to outperform both before and after the split. This is not surprising, since when companies see their shares rise to such a level that management feels it is appropriate to split the stock, this generally means that the stock has performed well. Correlation does not indicate causation.

Companies may also engage in reverse-splits, which results in investors owning fewer shares at higher prices. Typically, companies that engage in reverse-splits have seen their stock price decline often due to poor

fundamentals and excessive debt. If a company's stock falls too low it may be in danger of being delisted from stock and options exchanges. Companies that engage in a reverse-split may also want to appear more favorable to investors and not be branded as a "penny stock".

While stock splits are alluring to the media, it is important to remember that they ultimately do not impact the value of a company or investors' wealth. As always, be wary of individual behavioral biases. Wealth creation is born out of strong and improving corporate fundamentals.

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