Mesirow

How stock splits work

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Stock splits can often be a confusing concept for investors. Common questions can include: What does it mean when a company announces a stock split? Does the split change the company's underlying value? Can the split make the stock more affordable for everyday investors?

What is a stock split?

You are at an arcade with games that only accept $1 bills. Unfortunately, you only have a $10 bill so you ask the cashier to give you ten $1 bills in exchange for your $10 bill. There is no downside since the value exchanged is equal, you just effectively have more bills that add up to the same amount. Similarly, when a company splits its stock, it divides one share into multiple shares which lowers the stock price but does not increase the dollar value of the shares held. This increases the number of shares outstanding (i.e. the number of shares held), however since the price decreases in the same proportion, the total value remains the same.

Let's look at an example where ABC company announces a 4-for-1 split. This means that every shareholder with 1 share of ABC company will now own 4. If ABC's stock price is $450 on the day of the split, the new stock price will be $112 and there will be 4 times more shares.

	ABC Current	
Current Shares Outstanding	**Approximate Price**	**Mar**
4.28 Billion	$450.00	1.93
	After 4-for-1 Stock Split	
New Shares Outstanding	**New Approximate Price**	**Mar**
17.12 Billion	$112.50	1.93

A collection of all a company's shares outstanding multiplied by its price equals its market cap. In this scenario ABC company, currently has 4.28 billion shares outstanding and it is trading at around $450. Therefore, its current market cap is 1.93 trillion[1]. When ABC splits its stock, the number of shares will increase, but the price goes down by an equivalent amount, so there is no change to the market cap. In the case with ABC, the new shares available to buy and sell will be ~17 billion, but the new price will be ~$112 a share, meaning its market cap will stay the same at 1.93 trillion.

Companies can also do a reverse stock split. This is the opposite of a traditional stock split. A company might do a reverse stock split, where it reduces the number of shares and increases the price, for a couple of reasons. One reason might be to make the stock appear more valuable at a higher price. A second, more common reason, is that a company might need to maintain a certain price to stay listed on an exchange. In

either case, there is still no real effect on the value.

If you have specific questions about a recently announced stock split, your wealth advisor can explain any potential planning implications that may impact your portfolio.

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[1] **http://finance.yahoo.com/quote/aapl/history?p=aapl**