

A Sp/it Decision

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To split or not to split?

This is the question for an increasing number of companies' board of directors. During prolonged bull markets, as we've seen recently, stock prices have elevated to the point where stock split announcements have become a seasonal ritual at select companies.

In a stock split, or stock dividend, the number of shares held increases while the share price decreases proportionately. For example, the HAM company has 1,000,000 shares outstanding at a price of \$100/share. This equates to a \$100 million market capitalization. Now, if HAM's board of directors voted to split the stock 2 for 1, there would be 2,000,000 shares outstanding at a *market adjusted* price of \$50. This product still equals the pre-split market capitalization of \$100 million. No financial wealth is created. So why would an informed investor in the marketplace react favorably when a split is announced? Let's examine some potential reasons.

First, splits enhance the **liquidity and psychological appeal** of company's shares. A split lowers the share price, which typically makes the stock attractive to a larger group of investors. Most investors favor a \$50 stock to a \$100 stock. A larger investment audience can fuel demand and help drive its stock price north. Consider what the current prices of the following companies would be had they not split their stock:

Company	IPO Year	9/1/00 Price	# of Splits	Price today sans split
Pfizer	1983	\$42	5	\$ 2,064
Microsoft	1986	\$70	8	\$10,080
Cisco	1990	\$67	9	\$19,296
Intel	1973	\$70	13	\$80,190

Secondly, a stock split may be considered a **bullish signal** from management. Companies like to see their stock rise so it would seem unlikely that a firm would split its stock if it were bearish on its future prospects.

Thirdly, a board may decide to split its stock to draw attention to the company's perceived **undervalued share price**. The idea is that the split will cause analysts to reexamine the company and upgrade the shares. Rice University conducted a study that revealed companies who split their stock have outperformed, on average, comparable firms for as long as three years following the split.

Are we suggesting that you speculate on future split candidates? Not exactly. But the companies that split their stock repeatedly have certain common attributes: They are leaders in their industries, they consistently make money and they attract both individual and institutional investors. This suggests that stock splits, like other key performance ratios, are just another indicator of an outperforming company.

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