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Hoosier Dispatch: A Stock Split Primer

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It seems that the only thing greater than the hype surrounding stock splits these days is the sheer amount of misinformation floating around out there. Consider me your personal pool boy standing by with skimmer in hand to strain the waters so you can get a clearer view of what stocks splits are, what they aren't, how they work and what they mean to you as an investor.

From a technical standpoint, splits are about as exciting as getting change for a \$100 bill from your corner bank teller. The whole process is simply a way for corporations to keep their stock price within a certain trading range so shares don't end up selling for \$50K a pop, like Berkshire Hathaway (BRK.A:NYSE), as they grow over time.

In your standard 2-for-1 split, the company simply makes each share worth half as much as it did before the transaction. The postsplit value of all your shares is exactly the same as the presplit value. You just have twice as many shares at half the price.

Stock splits have absolutely no effect on anything – technically. Still, kids usually feel richer carrying twice as many coins down to Ben & Jerry's for a double dip of Chunky Monkey, so the effect can actually have some psychological value.

In fact there's been some conjecture about a significant and predictable pop in prices of stocks just after a split announcement. Rationally this shouldn't happen, but that's what makes it a market, right? After all, if enough people THINK a split is going to move the market then, by golly, it's GOING to move the market. It's sort of a self-fulfilling prophecy based on investor perceptions, and I'm not one to argue rationality with a herd of charging elephants.

One justification for the phenomenon is that lower share prices encourage smaller buyers to jump into the stock, thus bidding up the price. Supposedly, clients who can't afford, say, \$13,000

to pick up a round lot of Dell (DELL:Nasdaq) at the current price, will be happy to pony up \$7,500 for the 100 shares after a 2-for-1 split.

I even remember a couple of instances during my brokerage career when this would actually happen. A client would catch wind of a pending split and have me hold an order to buy 100 shares on the day it traded at the lower price rather than grab 50 shares immediately.

However, the whole idea that stock splits drive prices higher in the long run is like saying your hair grows because you cut it. Splits don't cause stocks to grow; it's the stock's growth that causes the splits. As a result, past price appreciation and regular splits kind of go hand in hand.

As for the mechanics of the deal, splits are often treated like the payment of a dividend complete with complications like record dates, pay dates and ex-dates. Using the recent example of Dell, the chronology of the deal goes something like this:

Feb. 18 (Declaration or Announcement Date): Dell announces a 2-for-1 stock split for shareholders of record as of Feb. 27. (Record Date): Dell closes the books on the split transaction and assembles its mailing list of shareholders to send the new certificates to. March 6 (Pay Date): Shares are paid out to shareholders on the list. March 9 (Ex-Date): Shares begin trading on the Nasdaq at their new split-adjusted price.

At this point I can almost see the wheels turning out there among the schemers in the crowd who think they've come up with a way to beat the system. "I'll just sell my 100 shares after the 27th for the presplit price of \$130 or so," they say to themselves in hushed tones, "and STILL get the new shares on pay date and make a cool \$7,500 on the deal, right?" Not so fast, slick.

Remember that there are no free lunches on Wall Street. If you sell 100 shares the day before the split takes effect, you'll be expected to deliver 200 post-split shares to clear the trade.

If you hold your shares electronically at a brokerage firm like most investors, the actual process is neat, clean and seamless. Keep your stock certificates squirreled away in a desk drawer or safe deposit box, however, and you'll soon receive a "Due Bill" sent by the buyer requiring you to fork over your new shares as soon as they hit your mailbox.

Conversely, if you buy 100 shares at the presplit price, you won't get gypped out of half your purchase when the dust settles. Think of it like buying or selling a fraction of the corporation instead of a fixed number of shares. If you strike a

deal for half of a pizza, it doesn't matter how many slices you cut it up into, the total amount is still the same. As a result, the Record Date becomes pretty much irrelevant from a shareholder's point of view.

If it sounds complicated, just key-in on the ex-date as your critical figure. That's when the stock will start trading at its split-adjusted price (usually the day AFTER the payment date). Everything else adjusts at that point, too (like 52-week high and low stats, and option strike prices, for example), so that two postsplit shares are treated exactly like one presplit share.

Since most companies try to keep their stock price within some pretty predictable bounds (although each company has a different set of numbers that it deems acceptable), getting the jump on potential split candidates is not all that difficult. If you're interested in following announcements more closely, Yahoo! offers a splits calendar on its finance site that might be useful.

Meaningless as it seems from an academic standpoint, folks perceive stock splits to have some value. Since perceptions are what drive stock prices in the short run, it makes sense to run with the throngs lest you get trampled underfoot.