Stock Market Review

Share splits explained

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The recent announcement by Medserv plc that it is convening an Extraordinary General Meeting on November 21 to approve a number of resolutions in connection with the re-denomination of its nominal value as well as a 2.5-for-1 share split, prompted me to explain the concept and benefits of share splits in my weekly article.

When a company performs a share split, the nominal value of each share decreases and, consequently, the number of issued shares rises. However, the total monetary value of the issued share capital remains unchanged and as such, this corporate action does not entail any dilution for shareholders. This means that the percentage stake held by each shareholder remains the same after a share split.

Since the number of shares in issue changes as a result of the decrease in the nominal value, the price in the market is adjusted to reflect the increased number of shares in circulation. As an example, if a company performs a 2-for-1 share split, the nominal value drops by half, the number of shares doubles and therefore, the share price should theoretically also decline by half.

Since the number of shares in issue rises, the financial metrics used to calculate some key investor ratios also change accordingly. The book value per share, the earnings per share and the dividend per share naturally all change as a result of the higher number of shares in issue.

However, the price to book value multiple, the price to earnings multiple and the dividend yield remain unchanged if the share price correctly adjusts by the same percentage as the increase in the number of shares.

Hence, if these ratios all remain unchanged, why do companies perform share splits?

Companies carry out a share split for various reasons. One of the main reasons is to lower the market price of each share. Retail investors do not view a high absolute share price too favourably since a high price is perceived as expensive.

Some investors feel uncomfortable buying high-priced shares and a split brings the share price down to a more 'reasonable' level.

A lower absolute price may encourage more buying interest which is one of the main benefits normally arising from share splits.

Another reason for performing such a corporate action is to increase the liquidity in an equity.

If there are more shares in circulation at lower prices, the shares generally become much more liquid which is another important advantage for the market at large.

American business magnate Warren Buffett had also undertaken a stock split for his company Berkshire Hathaway Inc. some years ago.

This took place in a different way with a new class of shares being created at a fraction of the original share price.

Currently, the 'A' shares of Berkshire Hathaway trade at over US$170,000 per share while the 'B' shares are priced in the region of US$114 per share. Naturally, for those retail investors wanting to invest in Buffett's company but not wishing or not in a position to pay US$170,000 for a single share, cannot acquire any 'A' shares but can purchase 'B' shares.

The advantage of the split in this particular case is therefore that of managing to attract investors with small amounts of investible funds who otherwise cannot afford to buy a share with such a high market price.

Over the years, a number of local companies also performed share splits as indicated in the table. The 2-for-1 share splits performed by BOV, HSBC, Lombard Bank and Middlesea Insurance between 1994 and 2006 took place purely to achieve the benefits described above.

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However, the more recent splits since 2008 served a dual purpose. As Malta adopted the euro in January 2008, shares which were previously denominated in Malta *lira* saw their nominal value converted into many decimal places as a result of 'euroisation'.

As an example, an equity with a nominal value of Lm0.25 per share automatically became a share having a nominal value of €0.5823.

As such, Lombard Bank, MIA, and Plaza first increased the nominal value of their shares through a capitalisation of reserves and concurrently performed a share split.

Medserv is now planning to carry out a similar exercise with an increase in the nominal value per share from €0.232937 to €0.25 through the capitalisation of €170,630 from the company's retained earnings. Medserv will then perform a 2.5-for-1 share split with the issued share capital of €2,500,000 being made up of 25,000,000 ordinary shares with a nominal value of €0.10 each from the previous 10,000,000 shares of a nominal value of €0.25 each.

Almost six years have passed since the adoption of the euro. Following the exercise being conducted by Medserv next week, Go plc and Grand Harbour Marina plc will remain the only companies that will have a nominal value of up to four decimal places.

The nominal value per share of Go plc is currently €0.5823 and that of Grand Harbour Marina plc is €0.2329. Perhaps they too should consider a similar exercise in the coming years.

Some companies also perform reverse share splits by reducing the number of shares in issue and, as a result, the share price rises accordingly. In a 1-for-2 share split, the number of shares held by each shareholder declines by half and as a result the share price in the market theoretically doubles.

While customary share splits are normally conducted to lower the absolute price to make the shares more marketable for retail investors, when a company's share price declines rapidly, a reverse split sometimes take place to keep the price from dropping below a very low level. Some financial market observers argue that a reverse share split is possibly regarded as a possible signal that a company is in danger and wishes the market to continue viewing it positively despite the free fall in the equity.

While many market followers advocate that companies should carry out share splits due to the psychological benefit that arises and the subsequent improvement in trading activity, some critics argue that since there is no change to the overall fundamental value to the company, there is no real benefit for undergoing a share split.

They contend that the only benefit is psychological rather than financial and the future performance of the share price will remain dependent on company developments, profitability and returns to shareholders.

In the final analysis, investors should continue to focus on the fundamentals of the company and its growth prospects. If the company reports positive announcements, its share price should benefit over time. However, retail investors would be more likely to invest in such a company if the absolute price is not too high. As a result, share splits are likely to continue to feature among the more frequent of corporate actions whether locally or internationally.

History of share splits in Malta

DATE	COMPANY	SPLIT RATIO
December 21, 1994	Bank of Valletta plc	2 for 1
December 21, 1994	HSBC Bank Malta plc *(previously Mid-Med Bank)*	2 for 1
April 1, 2005	HSBC Bank Malta plc	2 for 1
May 12, 2006	Lombard Bank Malta plc	2 for 1
June 28, 2006	Middlesea Insurance plc	2 for 1
May 3, 2008	Lombard Bank Malta plc	4 for 1
June 1, 2010	Malta International Airport plc	2 for 1
June 1, 2012	Plaza Centres plc	3 for 1
December 2, 2013	Medserv plc	2.5 for 1