Stock Splits and Spin Offs, No, This is Not a New Netflix Show. It is However a Popular Buzzword on Wall Street.

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While 'stock splits and spin offs' does sound like a fast-paced money heist themed drama, it is however far from it. Most recently, the news was flooded with two giant companies "Google and Amazon" stock splits announcement occurring in 2022. Seems fast paced and dramatic? It is! Read on to learn what it means and what all this drama leads to.

What are stock splits and how are they different from AT&T's Warner Brother Discovery spin offs?

Let's take a simple analogy of a pie, because who doesn't like them? The fragrance of a fresh baked pie wafting down the street on a warm summer afternoon. Nostalgia! Now that you've imagined that let's take the reference and apply it to finance. A pie is cut into four big pieces and shared amongst four people.

Now if you decide to cut smaller pieces and share it among eight people, this will not reduce the actual size of the pie but rather have more people relish smaller portions of the same sized pie. Similarly, a stock split occurs when the company's board members decide to lower the price of its stock by splitting each stock share in more than one share. The market capitalization or the company's total value of all shares traded on the stock exchange calculated by multiplying the number of total outstanding shares by current share price, like a pie does not change in total value even if the number of shares has increased and the price per share has been reduced, it is merely a cosmetic change. Generally, investors are more comfortable purchasing 100 shares of $20 price per share vs 20 shares of $100 price per share. In a stock split the total dollar value remains same but the number of outstanding shares increases, thus increasing the liquidity of the stock.

A few reasons why a company decides to do a stock split are, if the stock price of the company is too high then it makes it expensive for investors to acquire the company's shares and second an increase in total number of shares trading on an exchange helps to increase liquidity. Higher liquidity narrows the bid-ask spread for buyer and seller.

Amazon announced in March of 2022 a stock split of 20 for 1 occurring in June. One share of approximately $2,700 will now be divided into 20 shares of $135-140 each.

Let's look at a reversal of this strategy, "a Reverse stock split". Just as the name suggests, reverse stock splits are contrary to the above strategy. Think, building the pie back to bigger pieces. Here the companies intend to reduce the number of outstanding shares and increase the share price. Again, this will not have an impact on total company's value. The most prominent reasons why a company does a reverse stock split is when the share prices are too low and may cause the company to be delisted from an index or if the company wants to increase the share price to influence analyst and institutional / large investors.

AT & T completed the spinoff of Warner Brothers Discovery. All the shareholders of AT & T who held the shares end of closing date of transaction will receive estimated 0.24 shares of Warner Brothers Discovery for each AT & T common stock.

In a Spin-off, the parent public company separates one or more businesses or divisions into a newly formed publicly traded company. Think, Pie again. It is still the same sized pie. A part of that pie is now called a cake. Cosmetically you'll now own a pie and a cake. In technicality it is still the same pie being recycled for financial implications. The newly formed entity will be traded separately on the stock exchange under its own new ticker/symbol. Existing shareholders now benefit from holding shares of two separate companies. The parent company creates a spin-off by distributing 100% of its ownership in that business as a stock dividend to its existing stockholders. Spin-offs may prove to be lucrative as the management teams of separate companies will be able to focus on their core business models with better utilization of resources and streamlining workflow thus leading to superior performances and profit margins.

All the above strategies have their own merits and demerits. It ultimately depends on each company's strategic planning and goals and objectives.

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With over 10 years of experience in the fields of Investment and Financial Planning, Komal Motwani has worked and studies in institutions across globe, from India to Singapore and the US.

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