



A Split Is Just A Split!...

Citigroup recently announced a 1-for-10 reverse split on their outstanding common shares, set to go into effect on May 9th of this year.

If you own Citi shares or are planning on buying some, you may be wondering what this really means for you.

Stock Split

A stock split normally happens when management of a publicly traded company believes the company's shares have risen to a level that is too expensive for round-lot purchases (100, 200, 300...) by individual investors. This effectively shuts out a lot of buyers from trading the stock and reduces liquidity.

Let's use an example. Say ABC Company has 2 million shares outstanding at \$100 per share. Investors typically like to buy shares in round lots, so 100 shares of ABC cost \$10,000. While this may be okay for institutional investors, \$10,000 may be too much for individual investors.

To make the stock more attractive and affordable for investors of all stripes, ABC management decides to do a 2-for-1 stock split. So where someone held 100 shares worth \$100 each, they own 200 shares worth \$50 each after the split. Additionally, someone can now buy 100 shares for \$5,000 (as opposed to \$10,000 before the split).

Reverse Stock Split

A reverse split is the opposite of a normal stock split.

Companies opt for a reverse split when shares fall to a level where mutual funds, pension funds and institutions are either not allowed to purchase shares, or simply won't, because many companies selling for under \$5 are considered too speculative.

For example, when shares fall below \$1, they are delisted from the New York Stock Exchange (below \$5 for Nasdaq delisting). Delisted securities then trade over-the-counter (OTC) or on *pink sheets*, and see trading volume and liquidity drop.

A reverse split consolidates many shares into one. For example, if ABC shares drop to \$0.80 (80 cents), a 1-for-10 reverse split will reissue 1 share in lieu of 10, with a new price of \$8, which helps ABC avoid delisting.

In a reverse split:

- the company buys shares from those who hold less than a round lot
- major players – mutual funds, pension funds and institutions – get back into the stock, which increases trading volume and liquidity
- the company lowers the number of shares and as a result the stock price rises
- the stock can re-list on a major exchange and stay away from OTC or *pink sheets*

Citi's Reverse Split

Now back to Citigroup's 1-for-10 reverse split. Citi has about 29 billion shares, trading at around \$4.50 per share. After the reverse split, Citi will have around 2.9 billion shares, re-priced at about \$45 per share.

Even though the stock price increases after the split, the market capitalization (outstanding shares x price per share) stays the same because the number of shares goes down by a factor of 10 but the price per share goes up 10 times, balancing each other out.

Your Plan

In a reverse split, if you own less than 100 shares, you may be forced to sell and may want to consider buying more shares to reach a round lot. Splits also create temporary arbitrage opportunities due to share price fluctuations, which some investors try to cash-in on. However, if none of that applies to you then just sit tight and don't worry.

Theoretically a split should have no bearing at all on a company's share price. But many believe that shares trade lower after a reverse split. It sure feels like that some times. But concentrate on the business, not the split shenanigans. If the business prospers, your shares will do just fine.