

Bonus Issues, Stock Dividends, Stock Splits and Reverse Stock Splits (No Payout)

'Stock dividends' and 'bonus issues' are not really dividends at all since there's no cash payment from the company to shareholders. In a:

- 10% share dividend; which is the same as a
- 1 for 10 bonus issue; or a
- 11 for 10 stock split,

For every 10 shares that a shareholder owns, they will be given one new share in the company.

Since all shareholders receive this, the total number of shares increases by 10% ($=11/10-1$), but since the value of the firm's

assets is unchanged, the share price must fall by 9.09% ($=10/11-1$).

Some investors argue that stock dividends, bonus issues and stock splits are pointless since they do not increase shareholder wealth.

Reverse stock splits combine shares together, they're the opposite of stock splits. So a **1 for 10** reverse stock split turns ten shares into one. So the share price will be 10 times higher and the number of shares will be only one tenth of the previous number. The market capitalisation of equity will be unchanged.

Equivalence of Bonus Issues, Stock Dividends and Stock Splits

The following are all equivalent:

- Two-for-one stock split.
- One-for one bonus share issue.
- One hundred percent share dividend.

Each will mean that for every one share you already own, you will receive one extra share. So you will have two shares at the end for every one share you owned at the start.

Because no cash is paid from you to the company or vice versa, the value of the company's assets is unchanged and its total

equity is unchanged. However, the total number of shares will double and the share price will half.

The purpose of stock splits and so on might be to lower the share price when it gets 'too' high. A very high share price creates an indivisibility problem, making share purchases difficult for investors with small portfolios who wish to diversify.

For example, how many people can afford to add even a single Berkshire Hathaway Class A share to their portfolio?

<http://www.google.com/finance?q=NYSE,BRK.A>

Calculation Example: Stock splits, bonus issues and stock dividends

Question: A 2-for-5 bonus issue is equivalent to what sort of stock split and stock dividend?

Answer: A 2 for 5 bonus share issue means that for every 5 stocks you own you will receive 2 new ones for free. This means that you will end up with 7 ($=2+5$) stocks at the end, which is an increase in your number of stocks by 40% ($=2/5$). So all of the following are equivalent:

- 2-for-5 bonus share issue;
- 7-for-5 stock split;
- 40% share dividend.

Re-Investment (No Payout)

Instead of paying out equity in the form of dividends or buy-backs, companies can re-invest their cash by undertaking more positive-NPV projects which will boost their asset value and lead to capital gains for shareholders.