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Compass Points

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Stock Splits

The term 'frenemy' is used to describe personal, geopolitical and commercial relationships both among individuals and groups or institutions. It appeared in print as early as 1953 when Walter Winchell was quoted in the Nevada State Journal, "Howz about calling the Russians our Frienemies?" The term seamlessly blends the words fr(iend) and enemy, referring to someone who pretends to be a friend but actually is an enemy. It is also used to refer to a friend who is also a rival.

The board of directors of two frenemies recently authorized stock splits. Google split two for one. Apple split seven for one.

Stock splits generally have less significance from an investment perspective than all the 'noise' in the financial press would suggest. The share price changes on the day of the split but the market value of the investor's position remains the same. Sometimes however, splits can reveal useful information about corporate culture and governance practices.

Google

From a traditional perspective where one expects that the board of directors will defend shareholders interests, the Google split was not in shareholder's interests. In a typical two for one split, shareholders end up with twice as many shares all of which carry the rights and privileges typical of the pre-split shares. This was not the case with Google.

After the split shareholders held twice as many shares of stock but the shares were of two different kinds. One carried full shareholder voting rights. The other set were non-voting shares.

The terms and conditions of the split reduced shareholders voting authority by half while significantly increasing the voting authority of management. To be clear, there was no loss of value attributable to the split. There was, however, a loss of voting rights.

We will admit to ambiguous feelings about this decision. From one perspective this is an example of poor corporate governance. It is hard to argue that a board exercised its fiduciary duty to shareholders while taking away half of their voting rights. The split clearly consolidated additional power with management at the expense of shareholders.

From a different perspective, it could prove to be a prudent decision. This perspective requires us to take into consideration the tremendous cash balances on books of companies like Google and Apple. That cash attracts corporate raiders who often position themselves as shareholder advocates struggling against management to 'unlock' value.

In our experience, raiders are more often than not the corporate equivalent of a wolf in sheep's clothing, i.e., frenemy. Raiders lobby for board seats, argue for special dividend payments and generally attempt to browbeat management. They sing the hymn of shareholder interests just long enough to enhance their own equity position and leave.

By consolidating power in the hands of Google's founders and management, the board enhanced their ability to fend off corporate raiders. Only time will tell if that decision will be in the long-term interest of shareholders.

Apple

The seven for one split is another story altogether. There was no loss of voting rights in this case. We suspect the only reasoning driving the seven for one formula was a desire to drive the share price below $100.00. This is the old 'affordability' argument behind traditional stock splits. The reasoning is that the split makes the shares more affordable — available — to individual investors.

During the early part of Steve Jobs second tenure (the turnaround tenure) the Apple board authorized multiple splits as the company's fortunes improved and the stock price increased.

Later, the share price became something of a personal matter. A competition with Google over the share price ensued for Mr. Jobs. The Google board had not authorized a split since the IPO. Jobs argued that all Apple splits should be suspended until Apple's share price eclipsed the price of Google shares. As entertaining as this corporate celebrity competition was at the time, it was also pointless. Apple's market capitalization was vastly more than that of Google. The share price was clearly an incidental consideration.

Times change. Mr. Jobs has passed beyond any concern over the price per share of Google or Apple stock. The man who once lived so frugally that he neglected to buy furniture for his home, also publicly asserted that he would never " … own a yacht!" That same man left his estate encumbered with contract disputes with a marine architect over the design of his yacht.

Boards

What the boards of cutting edge companies like Apple and Google decide is important. The fact that they are often nearly invisible in the shadows behind the celebrities of corporate leadership does not change the importance of their role.

The Google stock split — as approved by the board — shows that someone is wrestling with a critical issue of who will exercise control over the future direction of the company. Only time will tell if they made a wise decision in 2014.

The Apple decision is less informative. This looks like a rerun of the old affordability argument that has little relevance. The widespread availability of index mutual funds and index ETFs (Exchange Traded Funds) make it possible to own such companies (along with others in the index) with relatively modest investment

Final Word

The final word on the 'affordability' argument's relevance to modern financial reality belongs to Berkshire Hathaway. The class A shares [BRKA] trade around $190,000.00 each. The B shares [BRKB] (first offered the year Stephen turned fifty) trade around $1,600.00. Neither share class has ever split.

For the record, we are not writing about any of these companies with the intention of commenting on their investment merits. We are focused on the importance of decisions made by boards and management that can directly impact shareholders and the value of their investments. We think good governance matters.

Thanks for your confidence and support,

Stephen & Susan