



Debt vs. Dilution: Should Shopify Inc. Take On Debt?

Description

For many investors who have piled in to **Shopify Inc.** ([TSX:SHOP](#))([NYSE:SHOP](#)) stock at higher and higher levels, dilution hasn't seemed to be a concern. The company's share price has risen on a torrid pace, increasing by more than 125% year to date on growth prospects that are rarely seen in financial markets today.

Shopify's growth prospects have largely been fueled by equity issuances. The company recently completed an equity issuance last month, announcing an over-allotment purchase by the underwriters of the May 24 offering of 825,000 shares over and above the initial 5.5 million shares agreed to be sold under the offering. The shares were sold at an average price of US\$91 per share, bringing the total aggregate proceeds of the transaction to US\$575,575,000.

With underwriters clearly cashing in on this transaction (as the current share price is now hovering above US\$97.50 per share), investors who are getting in at current levels are seeing their piece of the future earnings "pie" slowly become smaller.

Shopify's strategy of using equity issuances to raise money instead of taking on debt is not uncommon in the tech industry. While Shopify may be in a position to receive relatively favourable terms (length and rate) on debt, the company has chosen to forego leveraging up, maintaining a nil debt balance.

One of the reasons many companies choose to take on debt are for the associated tax shields accompanying the debt position. As a company's earnings continue to increase, reducing the business's net income through interest expenses is one way it can lower its overall effective tax rate. As Shopify is currently not generating earnings, building a debt load to provide tax shields for earnings down the road may not make sense just yet.

The company's equity valuation is also increasing at a faster rate than its dilution rate, meaning shares continue to rise, even though additional shares are being added — a sign that additional equity issuances may be coming down the road as Shopify continues its aggressive expansion plans.

Shopify's merchant e-commerce platform has done amazingly well over the past few quarters with quarterly revenue growing at a rate of 75% year over year. With its partnership with industry juggernaut **Amazon.com, Inc.**

([NASDAQ:AMZN](#)) helping to propel Shopify's platform towards becoming the default merchant services platform on the market, these recent equity issuances make sense in the grand scheme of things.

Bottom line

Shopify's business model is one which will rely on additional capital moving forward as the business works towards its longer-term goal of becoming profitable. While debt may not be in the works in the near term, investors can rest assured that the debt option remains a powerful lever the company can use down the road if needed.

Stay Foolish, my friends.

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