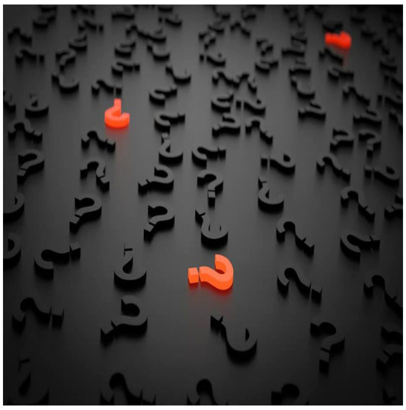

Was Andrew Left Right to Short These 2 Stocks?

Description

There is no question that the technology and marijuana industries have outperformed the market over the past few years, and equities within these spaces may be due for a correction. However, if the prolonged bull market continues, growth stocks can offer significant upside to investors who are willing to take on the risk.

As the old adage goes, a successful investor buys fear and sells greed. Perhaps this anecdote would have deterred rational folks from panic selling both **Shopify** (TSX:SHOP)(NYSE:SHOP) and **Cronos Group** (TSX:CRON)(NASDAQ:CRON) after renowned short seller Andrew Left released bearish reports against the companies. But then again, markets are irrational, and investor confidence can be swayed easily, which can cause price volatility.

Take for example the significant plunge to Shopify's stock price in late 2017. The e-commerce giant was targeted by a critical report released by Citron Research, and the company's share price decreased by roughly 11% as a result.

Described as a get-rich-quick scheme and compared to Herbalife, which was handed a hefty $200 million fine in 2016 for its business practices, the argument can be made that Shopify investors were influenced by Citron's claims. However, it does seem that this was a short-run phenomenon, as Shopify's share price recovered and has rallied to as high as $232.65 since Left's report.

Similarly, Cronos Group—an integrated cannabis distributor—saw its stock price decline after the release of a short thesis by Citron. Share prices decreased by roughly 28% after the company drew criticism for a lack of transparency surrounding its provincial supply agreements.

A few other issues the report highlights are the company's level of investment in R&D, relatively low international sales, and an expensive valuation. Again, the share price of Cronos Group has recovered since the release of Citron's critique.

Other than being targeted by a short seller, Shopify and Cronos Group share a similar characteristic: both equities are expensive from a fundamental perspective. The enterprise value (EV) relative to revenue can be helpful in illustrating a company's valuation when a firm's EBITDA metric is negative.

Both Shopify and Cronos Group generated negative EBITDA in 2017.

A simplified approach to calculating EV can be achieved by combining a company's market capitalization plus debt less cash. Shopify's trailing EV/revenue of 24.5 times could suggest the company's market capitalization is inflated. Cronos Group's trailing EV/revenue of 216 times also exemplifies a rich valuation.

Why have these share prices been on such a run?

Clearly, the market has priced the growth potential of Shopify and Cronos Group into their current valuations. Three indicators that may be helpful in evaluating a company's growth potential are return on equity, profitability, and return on assets.

Cronos Group has achieved returns on equity of roughly 2%, and Shopify has generated returns on equity of -3.94%. Neither company is profitable. They have returns on assets of -0.67% and -3.03%, respectively. It may be difficult to understand these valuations, and one could assume that speculative behaviour is holding influence over both of these stock prices.

Alternatively, Shopify and Cronos Group have attained exceptional year-over-year revenue growth, which could justify the current share price premiums. With strong earnings performance and effective management, both of these companies could see their future share prices grow. As of right now, it is difficult to tell whether the long or short strategy will garner the best returns without a significant level of guesswork.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

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2. NYSE:SHOP (Shopify Inc.)
3. TSX:CRON (Cronos Group)
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