Why Shopify's (TSX:SHOP) Stock Price Dropped 25.4% in 1 Month

Description

Shopify (TSX:SHOP)(NYSE:SHOP) has been on a legendary run ever since its initial public offering. Since mid-2015, Shopify's stock price is up by a whopping 1,111%. It's now larger than **ebay** and is the only e-commerce company next in line to **Amazon**.

By all accounts, business seems to be going great. Sales were up this past quarter, management raised their revenue forecast, and the company is upgrading its service by adding product 3D modeling features and a network of fulfillment centres. It has a tonne of cash (US$2 billion) and very little debt (US$114 million).

In other words, Shopify is a rare Canadian tech success story. Why, then, has the stock been plummeting since August? The company has lost nearly 25% of its value since the end of August. In fact, the stock is currently on its ninth straight day of losses — the longest in its history.

I believe the underlying reason for this depreciation in value lies in a few corporate actions this month that may have caught investors off guard and compelled them to reassess their holdings.

Management seems to think the stock is overvalued

Shopify's management team made a series of critical decisions this month.

On September 9, the company announced it would acquire warehouse robotics and software company 6 River Systems for US$450 million. I think this is a smart move that enhances Shopify's services and puts it in line with Amazon's peerless logistics network. However, 40% of this acquisition will be financed by issuing new shares.

That stock dilution didn't stop there. A week after the acquisition was announced, Shopify declared a new issue of 1.9 million shares at $317.50 per share in an effort to raise just over $600 million for ongoing operations.

As I mentioned earlier, Shopify already had enough resources to deploy in its fulfillment network and new acquisition, so this dilution seems somewhat unnecessary.

However, the company’s managers haven’t just been issuing new shares, they’ve also *been selling their own holdings.* According to data from public filings, insiders have collectively sold 270,000 shares worth US$43 million over the past 12 months.

The common thread between all these actions is simply overvaluation. Management seems to be indicating that the stock price has surged ahead of the company’s intrinsic value. Considering the way the stock has been punished this month, investors seem to be in agreement.

However, I believe the sell-off has also been intensified by the recent performance of tech startups across the world. The colossal failure of WeWork’s initial public offering this month may have done serious damage to the allure of all technology companies.

Foolish takeaway

Hyper-growth companies like Shopify need to raise external capital on occasion to keep the growth engine churning. Issuing new shares to raise funds or acquire a tech startup seems justified. But coupled with the fact that insiders have been selling their holdings as well, it seems to indicate that the stock could be overvalued.

Nevertheless, I believe Shopify remains one of the best technology companies in the country, and investors should look to add some exposure to this growth engine when the valuation adjusts enough.

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Date

2025/09/18
Date Created
2019/09/25
Author
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