Could Shopify (TSX:SHOP) Stock Make a Comeback by 2020?

Description

In recent years, **Shopify** (TSX:SHOP)(NYSE:SHOP) has arguably been Canada's favourite tech stock. After its mega-successful IPO and subsequent years of gains, it gained a much-deserved reputation as a stellar growth pick. At one point, Shopify had gotten so bullish that Jim Cramer opined it should be added to the "FAANG" list of hot tech stocks, which would be renamed "FAANGS" to reflect the new addition.

More recently, however, Shopify has begun falling, and its most prominent fan — the aforementioned Cramer — has dropped it. Starting on August 27, Shopify went on a dizzying slide, falling 27% by September 24. Long-term holders began to wonder whether it was time to exit their positions, while recent buyers had a major bite taken out of their portfolios. Since then, Shopify stock has staged a comeback, rising to $430 after hitting a low of $390. So far, so good. But will Shopify continue rising as we head into 2020, or is it merely treading water? To answer that question, we need to look at why Shopify fell in the first place.

Why it fell in the first place

In past articles, I've written extensively about fundamental and technical reasons for Shopify's selloff. These include a steep valuation, an unsustainable parabolic price trend, and decelerating revenue growth.

The factors above are all possible reasons why shareholders began exiting SHOP in August.

However, the really big contributor to the recent selloff was equity dilution. On September 16, the company announced that it had completed an offering of 1.9 million Class A subordinate shares worth US$600 million in total. The offering added cash to Shopify's balance sheet but diluted shareholder equity. The announcement corresponded almost perfectly to the stock's September selloff, indicating that equity raise was not taken well by Wall Street. This thesis receives further support from the fact that past equity raises by Shopify have also corresponded to declines in its share price.

How it could turn around

If equity dilution is the main reason that SHOP started falling, then the best way for the company to turn it around would be to use its new funds well. Although equity funding dilutes the ownership stake of each share, it can be worth it if it generates more value for shareholders. So, if through its upcoming investments, Shopify is able to ramp up revenue growth or move toward profitability, then its equity financing will have been justified.

The company is already posting positive adjusted earnings; if new investments grow those earnings or drive positive GAAP earnings, then the markets will likely react positively. An increase in revenue growth would also be a welcome development, since deceleration has been a major concern for investors in recent quarters.

Foolish takeaway

Even with its recent losses, Shopify has handily beaten the market this year. The question is whether it can continue doing so into 2020. It’s clearly not such a young company anymore, so investors may want to see GAAP profits or at least stronger revenue growth before buying the stock. Overall, this will be an interesting one to watch into the new year.

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andrewbutton