



## Will Shopify (TSX:SHOP) Continue to Drop?

### Description

A couple of months ago, I decided to let go of my long positions in **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)) and buy long [out-of-the-money puts](#). I have to admit, I was shaking in my boots at the time, with Shopify having such a strong run and the likelihood of losing all my money on options being quite high.

At the time, Shopify had an approximate US\$40 billion market capitalization on 2018 annual revenues of just over US\$1 billion. Even if Shopify were to maintain its current growth rate, it would take years for the valuation to make sense, and that was with the stock price remaining stagnant.

Ultimately, as is often the case with high valuation, the share price has come sharply down, around 25% below its highs. The sharp drop has resulted in an increase in the value of my put options. As soon as I could, I sold some higher-strike options to get money back as soon as possible. But the question remains: Will Shopify fall even further? Or is it time to take my gains and run?

Shopify remains stuck in purgatory, neither moving up or down substantially. In order to make a decision, I have to evaluate whether the stock has a lot of downside potential or not.

One thing is for certain, even with the 25% drop, the shares remain expensive. Remember: as of yet, Shopify is not really making any money. Its revenues are growing quickly, but they are still relatively small. The lack of earnings makes this a very difficult company to value, and therefore its investable thesis as yet still consists only of hopes and dreams.

Earnings are coming up on October 29; investors will get the latest glimpse into its growth and profitability. And unlike a few months ago, now there is an air of pessimism surrounding the stock as well as growth stocks in general. If hopes and dreams are dashed, then the stock could potentially fall quite sharply. It could quite possibly fall all the way back to its price where it sat a year ago at around US\$120.

However, should earnings shock to the upside, the downward trend could be largely reversed, leading to an upswing in the stock. I believe there is still no fundamental, profitability-based reason yet to buy this stock at this price. It will primarily be people's perceptions that matter.

Not that the dreams aren't based on reasonable hopes for growth. Shopify seems to have a great platform that is widely used. If you ignore share dilution as the company wisely peddles its (in my

opinion) overpriced shares to get cash for acquisitions and capital expenditure, its balance sheet appears to be quite strong. It has no real debt, which is quite a smart move from a business perspective.

## Where does Shopify go?

Two months ago, I was very certain. Shopify's stock [would go down](#). It has now done so quite significantly. With some of the air now let out of the bubble, I am less certain about its near-term future.

As a result, I have decided to take a different tactic. With my capital largely recovered, I have decided to hold my remaining long-dated puts on Shopify. I will, though, hedge my bets somewhat by purchasing a few out-of-the-money calls with November 15 strike prices at about \$3 a contract and Jan 17, 2020, calls at \$400 strike price.

This way, since my put options are already largely earning positive returns, a sharp move on earnings in either direction will, at the very least, make money. The worst-case scenario is for nothing to happen and the stock to not budge until expiry, which would result in total loss of premium.

For my part, I believe that Shopify, a richly valued stock that trades on hopes and dreams, will move sharply one way or the other, and that move will probably be down.

If it does fall substantially, I will probably use some of my options proceeds to buy shares in the company, as I believe that Shopify has a great business model and a bright future — just not at any price. But it all depends on whether the upcoming earnings report inspires hope or breeds fear.

### CATEGORY

1. Investing
2. Tech Stocks

### TICKERS GLOBAL

1. NYSE:SHOP (Shopify Inc.)
2. TSX:SHOP (Shopify Inc.)

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krisknutson

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