Shopify Inc. Shareholders Are Wise to Consider John Chen's Valuation Comments

Description

BlackBerry Ltd. (TSX:BB)(NASDAQ:BBRY) announced mixed first-quarter earnings results June 23 which knocked its stock for a 12.3% decline.

The same day as earnings were released, BlackBerry CEO John Chen appeared on BNN to discuss what's ahead for the company. His comments about tech valuations were especially enlightening.

"The valuations have been crazy," Chen told BNN. "People are making a lot of paper profit right now. There is going to be a time when they are going to want to take that profit off the table."

It's possible that Chen's comments about tech valuations being sky-high were a way for him to sweep the company's poor top-line results under the rug.

Alternatively, it's also possible that the tech industry veteran understands that overpaying for assets, especially when you are in the middle of a turnaround/transformation, is the kiss of death for any company struggling to find its footing.

Any way you slice it, Chen's comments should be a wake-up call for **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP) shareholders, who've seen its stock price increase by 214% over the past year, despite the fact it doesn't make money and might not for another year or two.

Shopify's Valuation

I was once a skeptic of Shopify's stock, suggesting in October 2016 that despite operating an exciting business, it wasn't worth nine times sales.

"I still question the wisdom of buying Shopify at nine times revenue when you can own Amazon, a company with almost US$9 billion in free cash flow, for three times sales," I wrote at the time. "I just can't shake that."

Then in February, I relented, suggesting that it was Canada’s best tech stock.

What changed my mind?

Shopify has a growing business where scale is more important than profits — at least in the near term.

“Because Shopify is growing so fast — 90% year-over-year increase in revenue and 99% year-over-year increase in gross merchandise revenue — a full-year operating loss of US$37.2 million hardly seems like a huge concern, especially when it has US$392.4 million in cash on hand and no debt,” I wrote in February.

Four months after my October 2016 recommendation for investors to pass on SHOP stock at nine times sales, it was trading at 14 times revenue, yet I had jumped on the Shopify bandwagon.

Using stock as currency

Finally, at the end of May, I argued that Shopify’s sale of stock made more sense than issuing debt, because who knows when another opportunity will come around for Shopify to use its stock as currency, selling shares at 21 times sales?

It struck while the iron was hot.

“By almost any metric, Shopify stock isn’t cheap,” I wrote on May 29. “Using it as currency at a time when investors are willing to pay almost anything to own it is a smart move, in my opinion.”

Bottom line

Since October 2016, Shopify’s P/S multiple has more than doubled.

While it’s not unusual to see multiple expansion from fast-growing companies, John Chen’s comments should at least make long-time shareholders reconsider their commitment to holding its stock through a possible correction.

Are tech stocks severely overvalued, as Chen proclaims? I believe they are.

However, if you can hold for three to five years, there’s no need to worry about a possible correction. Time will take care of any short-term price gyrations that might occur in the next six months to a year to shake out the weak hands.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. NYSE:BB (BlackBerry)
2. NYSE:SHOP (Shopify Inc.)
3. TSX:BB (BlackBerry)
4. TSX:SHOP (Shopify Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Yahoo CA

Category

1. Investing
2. Tech Stocks

Date
2025/08/24
Date Created
2017/06/27
Author
washworth