A Troubling Trend for Shopify Inc and Why You Should Avoid the Stock

Description

Shopify Inc (TSX:SHOP)(NYSE:SHOP) released its second quarter earnings last Tuesday and, despite revenues soaring up to over $151 million and being up 75% year-over-year, the company still could not turn a profit. Not only did the company not turn a profit, but its loss for Q2 was actually higher than what it was a year ago. Despite the inability to turn a profit amid soaring sales, the share actually went up almost 14% because results were not as bad as expected.

The problem is the results were still bad, and the company's gross margin was actually higher this year (57%) compared to last year (53%). If the company's gross margins are strong, that tells us the problem comes from the company's overhead or operational expenses. I'll dig into the income statement a bit more to see where the profits have been disappearing.

Rising operating expenses

Operating expenses in 2016 totaled $56 million and were up to over $102 million in Q2, for a total increase of 82%. Among all of its different line items (research & development, sales & marketing and general & administrative), the company saw increases in employee-related costs.

Research and development saw the largest increase in employee-related costs with $13.4 million, followed by sales and marketing which saw increases of over $10.7 million, and general and administrative had employee costs go up by $2.2 million. In total, $26.3 million of the $46 million (57%) increase in operating expenses can be attributed to employee-related expenses.

The other large driver in the company's cost increase was $13.6 million more spent on marketing programs that included advertising on social media and search engines. Combined with increased employee costs, this explains $39.9 million, or 87% of the inflated operational expenses.

Expenses outpacing sales

Perhaps the most troubling issue with Shopify is not that its expenses are growing, but that revenues are struggling to keep up. With start-up companies, you will expect years of high expenses and low profitability, but Shopify is showing no evidence that it is creating any efficiencies.

In the past three years the company's sales have grown from $50 million in 2013 to over $389 million at the end of Shopify's last fiscal, for an increase of over 675%. The company has been essentially doubling its revenue every year, which is no small feat.

The bad news is expenses have been more than keeping up with revenue growth. In 2013, expenses of $54 million were 108.5% of total revenue for the year. Since then, expenses have shot up over 682% for a total of $426 million and representing 109.5% of revenue.

Expenses have outpaced revenue growth, and as a percentage of revenue, costs have increased, as well. But let's dig a little deeper and see if quarter-by-quarter there have been improvements.

In the past four quarters revenues have grown by 75%, for an average increase of 15% per quarter. During the same time frame expenses have increased by 75.8%. In the company's most recent quarter, expenses climbed to 10.5% of revenue, up from a year ago when expenses made up a shade under 10% of sales.

Bottom line

I would have expected the company to have achieved some efficiency by now, and its increasing cost structure concerns me that management is only concerned about its top line. Investors shouldn't be influenced by hype and should demand more from a company than just sales.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

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

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing
2. Tech Stocks

Date
2025/07/03

Date Created
2017/08/07
Author
djagielski