3 Reasons to Sell Shopify Inc. Despite its Promising Growth Profile

Description

Shopify Inc. (TSX:SHOP)(NYSE:SHOP) plunged as low as ~9% on Tuesday following the long weekend, when many investors have decided it may be time to throw in the towel on the high flyer, which has still more than tripled in value since its IPO a few years ago. Shopify is now down ~24% from its September high, and while it may seem like a good time to load up on shares on the dip, there are three major reasons why shares could continue to get hit over the coming months.

Shopify's subscriber base isn't as sustainable as most investors originally thought

In a previous piece, I'd warned investors of a scary risk that nobody seemed to be talking about. At the time of publication, everyone was euphoric on Shopify in spite of its absurd valuation. Many investors flocked into Shopify because of the subscriber growth momentum the company was experiencing. What many investors didn't consider is how long these new subscribers would stick around or if they'd be heading for the exits shortly after.

I'd pointed out that small- and medium-sized (SMB) businesses have a high probability of failure within the first few years of their existence. That meant that a huge chunk of Shopify's subscriber base would deteriorate gradually over time. That meant Shopify's subscribers weren't as "high quality" as many investors may have hoped for.

To add more salt in the wound, Andrew Left pointed out that many "subscribers" were actually just in it to make referral income through the company's affiliate-based marketing program. Mr. Left compared it to **Herbalife Ltd.**, which is a company which experienced a tonne of churn. I believe Shopify will inevitably experience this kind of churn down the road, shortly after the company hits peak subscribers.

Shopify is still ridiculously overvalued (even for a high-growth tech stock)

In many previous pieces, I'd also warned investors that the multiples they were paying for Shopify were absurd. Even after falling ~24%, the stock is still really expensive with a ~17 price-to-sales multiple.

Sure, many investors don't really take value into consideration with rule-breaker tech stocks, but if a company isn't making a profit, and its subscriber base isn't that stable, many investors should be asking themselves if it’s really worth taking a bet on a dangerously speculative company that had more than quadrupled from its IPO price to its all-time high.

Andrew Left will probably be back with more fear-inducing reports

Andrew Left of Citron Research released a short video, and you can bet that he’ll be back with more dirt on the company, whether it be through a new video, a report, or a televised interview. He has declared war on Shopify, and that’s really bad news for shareholders who were hoping to buy more shares on the dip.

Bottom line

Greed has turned to fear in what seems like an instant. My concerns about Shopify were confirmed by Mr. Left and Citron, and I’d advise investors who are still bullish on the company to be very cautious when trying to catch this falling knife. Mr. Left believes that shares of Shopify could lose over half of their value should the U.S. Federal Trade Commission undergo an investigation of the company’s questionable business practices.

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