



Why I'm Still Not Buying Shopify Inc.

Description

So, here we are. **Shopify Inc.** ([TSX:SHOP](#))([NYSE:SHOP](#)) is trading at ~\$118 after declining 21% from its highs of \$150 hit on September 18.

The most obvious issue that I have with this stock is the valuation. With this stock, I am reminded of the dot-com era, when all reason was thrown out the window and technology stocks were being valued at wild and euphoric levels.

We all remember how that ended.

A closer look at valuation

The stock is now trading at 18 times sales, which is better than the 23 times that we had been seeing prior to the most recent drop, but it's still high.

But at the end of the day, we will eventually be valuing the company on earnings, cash flow, and returns, because those are the things that drive shareholder value.

According to consensus earnings estimates, the company should post EPS of \$0.21 in 2018 and \$0.55 in 2019. Assuming this is correct, that would mean that the stock is trading at a P/E ratio of 560 times 2018 earnings and 215 times 2019 earnings.

How long would it take the company's earnings to grow into these kinds of valuation numbers?

It would take a very, very long time. There are too many uncertainties and risks for me to risk my money and wait.

Financials

Shopify is in the early stages of its business development. So, the stock has been trading mostly on revenue growth, which has been super impressive. The latest quarter saw a 75% increase in revenue versus the second quarter of 2016.

But we cannot ignore the fact that the company is in the stage of trying to actually turn a profit from what has been a booming business.

Losses at the company are lessening, with the second quarter reporting an operating loss of \$15.9 million, but investors are still waiting for profit. At least the balance sheet has \$965 million in cash and short-term investments to take the company through its period of losses.

We can make educated guesses as to where we believe margins will settle and where Shopify will end up in its very competitive market, but the truth is that there is still a lot of uncertainty and way too much optimism baked in to the stock.

Business model

If a big percentage of businesses that sign up fail and consequently cancel their subscription to Shopify's services shortly afterwards, there is a problem with Shopify's business model. As investors, we should look for businesses that have "sticky" and repeat customers, not a high churn rate.

And then there are the questions of the company's marketing and promotional strategy, which is highly aggressive.

Shopify is expected to release results at the beginning of November. While the company has been pretty much silent in response to Mr. Left's criticism of the company, one would hope that it will be addressed further at that time.

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