Shopify Inc. Reports Earnings, Shares Fall, But it's Only the Beginning

Description

Earlier this week, **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP) reported quarterly earnings, which disappointed on the growth front, but surprised on the upside in regards to the company's ability to report a positive earnings number for the first time (when adding back stock-based compensation).

Given that the company has recently come under the microscope of short seller Andrew Left of Citron Research, there is no shortage of excellent coverage about this name. As a reminder, Andrew Left is the short seller responsible for highlighting the business practices at **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), which contributed to a decline in the share price from more than $325 to a current price of less than $15.

After earnings were released, shares found a comfortable level around the $125 mark near midday, as investors dissected the news. Many chose to flee rather than remain patient. Essentially, the news was actually very good for long investors, but it simply was not good enough.

When considering revenues and the cost of revenues, shareholders should be very happy. Year over year, top-line revenues increased by 72% for the quarter, as the company successfully increased revenues in the merchant solutions side of the business much more than the subscription solutions side. The cost of revenues (similar to cost of goods sold for a traditional business) decreased substantially on a percentage basis from 46% of revenues for 2016 to 41.6% for the current year.

With a much higher amount of gross profit to begin with, shareholders who would have been right in assuming they would be in at least the middle lane (of a three-lane highway) are in fact stuck behind a few challenges. The amount of operating expenses as a percentage of revenues have increased substantially from 63.5% for last year to 65.7%. Let's not forget that these percentages are based on revenues which have increased by approximately 72%! Clearly, expenses have gotten away from the company as it has had to focus on other things.

In spite of continuing to grow the top line at a substantially high rate, investors who have enjoyed an incredible run with this name may now need to reconsider just how long they want to hold this stock. In spite of declining more than 10% in earnings, shares remain in positive territory, as the 50-day simple moving average (SMA) and the share price remain well above the 200-day SMA. For those not aware of technical indicators, this metric is a sign that the stock remains in bullish territory in spite of pulling back. Once the share price and the 50-day SMA cross below the 200-day SMA, it will be a sign of a bearish market for the stock.

For investors holding on to this security, it is important to remember that with the potential for incredible growth (and return), there is going to be a substantially higher amount of risk. A decline of 10% may only be the beginning, as expenses at this company continue to increase at an alarming rate.

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Date
2025/07/29
Date Created
2017/11/04
Author
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