Shopify Inc.: Why Shares May Correct to $90 Before the Next Sustained Rally

Description

Shopify Inc. (TSX:SHOP)(NYSE:SHOP) plunged back into the $120 levels after a broader tech market sell-off, which saw many investors move cash from speculative tech stocks and into value names. Canada's high-flying tech stocks are few and far between, so it's no mystery that many Canadians may be overexposed to Shopify, whose stock has been on a roller-coaster ride over the last six months.

Shares are still expensive

While shares of Shopify are definitely cheaper after a period of consolidation, I still think investors should be cautious, since shares are still ridiculously expensive, even when considering the company's top-notch growth profile. There's expensive, and there's Shopify expensive, which is on another level!

Shopify shares trade at a whopping 15.3 price-to-sales multiple, which is higher than many of the highest-flying stocks on the NASDAQ exchange, including **Square Inc.** and **Nvidia Corporation** with price-to-sales multiples of 6.8 and 13.5, respectively. On a price-to-sales basis, Shopify makes these explosive growth plays look cheap.

With short-seller Andrew Left on the minds of many shareholders, the possibility of a mild correction is just as probable as a sustained rally higher over the next year. Shopify stock is in limbo right now, and not even an incredible quarter could propel the stock out of its funk, as is the case with many other speculative tech names that have surged above and beyond what's considered realistic.

Could the recent rotation from speculative tech names be another drag on Shopify?

With no recent news, Shopify shares have pulled back violently over the past week due to the broader weakness in the tech sector. Highly speculative and overvalued names got crushed, and should the industry rotation out of tech continue in the weeks ahead, it's very likely that Shopify will continue to experience pain. And who knows? Andrew Left may have more bearish comments to rub more salt in the company's wounds.

Quarterly beats may not be enough to propel shares out of their funk

Tobias Lütke, Shopify's CEO, and company haven't really addressed the real concerns that Left pointed out in his short thesis. Until management can shed more light on churn rates, I suspect the stock will continue to struggle to sustain a rally to new highs, especially since investors are already expecting perfection once the next quarterly results arrive.

Even as Shopify increases its operating profit in 2018, Left's concerns will probably end up spoiling the party again.

Bottom line

Shopify is a wonderful business in a rapidly emerging industry, but the valuation doesn't make sense, and there are way too many headwinds that could come back to bite the company, as its stock continues to consolidate. Andrew Left will probably continue to be a thorn in the side of the company throughout 2018. And if the broader tech pullback continues, we could very well see Shopify at $90 at some point next year, even if the next quarter is spectacular.

In addition, the company has continued to beat analyst expectations by a considerable amount of the bottom line. With shares pulling back after the latest earnings beat ($0.05 EPS vs. -$0.02 EPS consensus), just imagine what could happen to the stock if the company ends up coming short of expectations.

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