Is Shopify Inc. (TSX:SHOP) Headed for a Big Correction?

Description

Shopify Inc. (TSX:SHOP)(NYSE:SHOP) stock has done a great job of producing strong returns for investors over the years, but it's going to need to do a whole lot more to convince buyers it's worth the big price tag. In the past three years, the share price has risen over 400%, and early investors have done very well. However, recent investors may have not been so lucky, as the stock has proven to be very volatile over the past year.

The share price has been erratic, seeing big drops in price by any perceived negativity, only to eventually rise back up again. While investors may see this as an opportunity to take advantage of technical analysis and time the stock correctly to make a great profit, there are some big concerns that the share price could be headed for a longer, deeper fall next time.

Growth is expected to see a big slowdown

What has excited investors about Shopify is the growth it has achieved and the potential it still has. The problem is, in its most recent earnings report, the company's guidance was soft, and the concern is that Shopify may be starting to see limitations of its future growth potential. And this was before news came out that a competitor was being acquired by a big tech giant — something that could have an adverse impact on Shopify's market share over the long term.

A quick look at its numbers illustrate this very well. In 2014, sales more than doubled, while the following year we would see a similar result. In 2016, the top line was up 90%, and in 2017 it rose by 73%. In its last quarter, sales rose 69%, and the company expects that number to come down even more.

It's not surprising that the company has slowed down given that its sales are much higher than the $50 million that Shopify generated back in 2013, but the rate of decline is concerning.

The stock is heavily overpriced

Growth stocks are expected to trade at big premiums, but Shopify's price is steep, even amid all the hype surrounding it. At a price-to-book ratio of 15 and 25 times sales, those are very large multiples for the stock to be trading at, especially given that growth is slowing down. We can't even mention price-to-earnings because despite its strong sales growth, profits have eluded Shopify.

Sooner or later, investors are going to start paying closer attention to the company's lack of profitability, and that could put a lot of downward pressure on the stock price.

Bottom line

Shopify has been a fragile stock lately, and it could expose investors to a lot of risk, as the share price has gone on steep declines in a short amount of time. For the stock to climb higher than its 52-week high of $202, it will have to come out with something big; otherwise, hype alone won't get the stock there.

Although the share price is up more than 40% since the start of the year, in the past three months the stock has produced only single-digit returns for investors.

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