Shopify Inc. (TSX:SHOP) Q2 Results: 3 Reasons I'd Be Selling

Description

Shopify Inc. (TSX:SHOP)(NYSE:SHOP) was down more than 5% on Tuesday as the company released its quarterly earnings, which despite strong growth, failed to impress investors yet again. Sales for the quarter were up 62% from a year ago; however, investors will note that the rate of increase has declined. In Q1, Shopify's revenues were up by 68%, and that was already a decline from prior periods.

The company was forecasting a lower rate of growth for the remainder of the year, so it shouldn't come as a big surprise that sales have slowed down. The bigger problem is that costs continue to outpace revenues, as operating expenses were up 63% from the prior year. Gross profit was also down, from over 57% a year ago to slightly under 56% this quarter. As a result of the lower margins and higher costs, Shopify's net loss of $24 million was deeper than the $14 million loss that the company recorded in 2017.

There are three reasons investors should be concerned about Shopify's latest earnings, and why the stock may not be a good buy today.

The growth rate is declining, fast

The importance of growth for Shopify really can't be understated, as that's what's made the stock so popular among investors. While its business model may suggest that it should still have plenty of growth opportunities ahead of itself, the sharp declines in sales growth might be raising alarm bells that Shopify's high-growth days may be behind the company. Although a 62% rate of growth is nothing to scoff at, with soft guidance, it's hard to for investors to get excited about a company that's showing signs of slowing down.

For tech stocks — especially those that are traded at high multiples like Shopify — it's all about growth and constantly performing well.

Profitability remains nowhere in sight

One of the big reasons investors focus on growth is because Shopify is nowhere closer to turning a profit, and it's actually moving further away from break even. While that may be an excuse for high-growth stocks that are expanding at a strong rate, the slower that Shopify's rate of growth gets, the more emphasis investors will place on profitability, which could be a big problem for the stock.

Expenses haven't been manageable, and when costs continue to rise higher than revenues, it could be a recipe for disaster down the road.

The company continues to burn cash

In the trailing six months, Shopify has failed to generate positive cash flow from its operating activities, although it has improved from a year ago. And with a lot of investing activities to fund, Shopify has to rely on the equity markets to help manage its cash needs. Since last year, its weighted average number of shares have risen by over 12%, which is bad news for shareholders as it results in a dilution of ownership.

Bottom line

Shopify's been a volatile stock this year, and these results could send it back on the decline. The company will need to do a lot more to prove that it is a suitable long-term investment, as recent results suggest that its best days may already be behind it.

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