Shopify Inc. (TSX:SHOP) Stock Is Down 20% From Its Highs: Buying Opportunity?

Description

Shopify Inc. (TSX:SHOP)(NYSE:SHOP) stock is down almost 20% from its highs of the summer, as the market in general has become more risk averse.

Let's dive a little deeper into Shopify stock to see what's going on and what investors should do at this point.

Rising interest rates impact a stock's valuation, as in a discounted cash flow analysis, the denominator (interest rate) rises, thus reducing the present value of the stock.

And stocks like Shopify, which are valuing cash flows far into the future, will see an even bigger impact.

I think you will see that while Shopify is definitely in a business of the future, fundamentals really need to play catch up to the stock price, as Shopify stock is one of those stocks that have benefitted from investor expectations and excitement over and above fundamentals.

And the company's involvement in the marijuana industry has exaggerated this, as we have seen Shopify stock price rise with the same force and exhilaration as marijuana stocks, some of it justified, some of it maybe a little too much, too fast.

As such, a lot of the good news is in the stock price already.

Here are some of the fundamental issues and risks that investors need to keep in mind:

Total revenue increased 58% year-over-year, but the company is seeing a slowing revenue growth rate amidst increasing expenses, which is typical of a growth company, and highlights the risks inherent in this stock.

In the latest quarter, operating expenses increased 61% as the company continued to invest in the business and its geographic footprint.

Accordingly, net loss was $0.22 per share compared to $.09 per share in same period last year.

Shopify had $1.58 billion in cash at the end of the quarter, but the company has been burning through cash rapidly as it strives to grow and maintain its position.

You might have noticed that the company did finally report positive operating cash flow in the last nine months, to the tune of $67,000.

It is certainly a positive development, but if we include capital expenditures in this number, we can see that the company actually used more than $36 million in cash.

Again, all this is normal for a growth company in its early stages and it partly explains the risk.

So Shopify has been working hard at increasing recurring revenue and increasing its revenue from larger businesses, which, as we can see in the latest results, it has done successfully.

Merchant Recurring Revenue (MRR) in the quarter grew at a rate of 41% in the last year, and Shopify Plus contributed 25% of MRR versus 20% in September 2017.

We can expect continued elevated expense on research and development as the company attempts to strengthen its competitive advantage in its highly competitive industry.

Churn rate is still an issue and shareholders have had to deal with dilution which has come with stock issuances to fund growth.

As investors, we should expect Shopify's stock price to continue to be volatile, and for it to come under excessive downward pressure if and when investors continue to react to higher interest rates, and if and when results do not match expectations.

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