The Holidays Bring Cheer to Shopify's (TSX:SHOP) Bottom Line

Description

If there's one thing that defines retail in the Western world, it's the holiday season. Retailers, both digital and physical, brace for a spurt in sales as people buy all the gifts they'll need by Christmas morning. This makes the final quarter of the year the most important one for e-commerce giants like **Shopify** (TSX:SHOP)(NYSE:SHOP).

According to the latest industry data, this year's holiday season is already looking brighter than last year's. Online sales in November crossed $58 billion in the U.S. alone. With Christmas shopping still underway, online sales are expected to cross $65.5 billion in December alone.

The three biggest shopping days of the year — Black Friday, Thanksgiving, and Cyber Monday — clocked in $6.2 billion, $3.7 billion, and $7.9 billion, respectively, this year. This helped Shopify process a historically high $1.5 billion in Gross Merchandise Value (GMV).

Shopify's GMV growth rate was nearly double the rate of U.S. online sales growth. It's a positive development for a company that needs relentless growth to justify its lofty valuation.

The holiday cheer should trickle down the bottom line and show up in the fourth-quarter results. Q4 sales have always been noticeably higher than the rest of the year. Last year, Shopify reported $222.8 million in revenue during the December quarter. This year analysts are expecting December quarter sales to cross $321 million.

If Shopify can meet or even beat analyst estimates for the holiday quarter, it would imply a growth rate of 45%. For any other company, a 45% growth rate would be undeniably impressive. But Shopify needs to grow a lot faster to justify its valuation.

Valuation

The company trades at a price-to-sales ratio of 19. If you account for the December quarter, that ratio could move down to 16.7. Earnings per share and operating cash flow are both negative. This wasn't the case for **Amazon**.

Although Amazon has reported a loss for much of its history, Jeff Bezos has managed to finance its expansion with positive cash flows over the past two decades. Shopify isn't a retailer as much as it's a software-as-a-service provider, but the same principle applies.

Shopify has a history of selling shares to finance its growth. Without positive cash flow, the company must rely on external financing to tap into its growth potential. With that in mind, investors should brace for further dilution in the near future.

How does an investor decide if Shopify is undervalued or overvalued when there's no indication of how many shares the company will issue soon or when cash flow will turn positive? None of the traditional valuation metrics apply.

All investors know for sure is that Shopify has a unique business model, a great management team, and it grows faster than most traditional businesses and slower than it did in the past. Is that enough?

Even if holiday sales are better than expected, it might not push the needle for investors. The future growth rate and possible dilution make it difficult to pin down the company's intrinsic value. I believe investors who want growth at reasonable prices should wait and watch till there's more clarity on either of these two metrics.

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