3 Problems with Shopify's (TSX:SHOP) Latest Earnings Report

Description

Shopify (TSX:SHOP)(NYSE:SHOP) saw its share price jump on Tuesday by 7%, as it reached a new all-time high after the company released its first-quarter results. However, despite the excitement, there were some areas of concern on Shopify's financials that investors shouldn't ignore.

Costs continue to outpace revenue growth

While the headlines will read that Shopify's sales grew at 50% year over year, that's only part of the story. Cost of goods sold rose by 55% and resulted in a slightly lower margin from a year ago. Operating expenses also grew a little higher than sales. Interestingly enough, it was general and administrative expenses that saw the biggest increase, climbing 68% from a year ago.

The bad news for investors is that increase in revenues means very little if the company cannot control its costs, especially administrative costs. Even if it could keep costs stable, then at least the incremental revenue would help flow through to the bottom line and help Shopify cover its operating expenses. Instead, expenditures continue to soar and are a continuation of a troubling trend we've seen before.

Profitability remains a big question mark

Due to the rising costs and new business ventures, it's looking less and less likely that Shopify will turn a profit any time soon. With a net loss of $24 million, that's a 52% increase from the $15.9 million loss that the company incurred a year ago. You'll notice that just about everything is growing at a higher rate than Shopify's sales.

And while some reports may claim the company posted a profit, the truth is it was only adjusted earnings that were positive. The danger with relying on adjusted figures is that they take out relevant expenses and don't truly reflect a true profit number. It's all too convenient for companies to stuff expenses that they can later adjust out, and that's why I'd encourage investors to ignore those figures.

Profitability has remained elusive for Shopify, and now that the company is going into producing TV and film, it's only going to lead to even more expenditures. Rather than cleaning up its costs and trying to get closer to breakeven, the company is working on developing a segment that is not crucial to its business. The problem here is that Shopify is making it easy to make excuses in the future for continuing to not make a profit.

Growth rate continues to decline

Shopify barely hit 50% growth this quarter, and it's likely that in future quarters that number will get closer to 40% before the year is over. This is a trend we've seen from Shopify for some time. And although it would be irrational to expect the company to continue growing at more than 50% every quarter, it highlights the need for the company to start cleaning up its act.

The lower the growth rate gets, the less investors will be willing to pay such high premiums for the stock, especially given its inability to produce a profit.

Bottom line

Shopify is forming a bubble that could pop very soon. And while investors may scoff, saying that its growth will continue to carry the share price higher, we've already seen how quickly things can turn south.

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