



Should Shopify (TSX:SHOP) Investors Brace for More Pain?

Description

It's been a tough September for **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)) shareholders. After peaking at \$540 in August, the stock went into a free fall, shedding 15.6% of its value in September and 20% from its August peak. The reasons for the selloff aren't clear; Jim Cramer attributed it to a [parabolic price trend that couldn't continue](#), while others blamed the stock's nosebleed valuation. Regardless of why Shopify is tanking, there's reason to believe that investors should brace for more pain. The following are three key reasons why.

Nosebleed valuation

Shopify is easily one of the most expensive stocks on the Toronto Stock Exchange. Trading at 38 times sales and 22 times book value, it's mind-blowingly costly. While the company's revenue growth is pretty strong (it's been averaging around 50% year over year), it's not enough to justify the kind of price the stock goes for.

Granted, we've seen stocks trade at high P/E ratios for extended periods of time while seeing strong price gains. **Amazon.com** has always had a high P/E ratio and has nevertheless kept going up in the markets. But AMZN is nowhere near as expensive as SHOP right now, and it always had a stronger market position in its industry. Amazon is *THE* online store for businesses to sell on, Shopify is only one self-hosted e-commerce platform among many: vendors lose access to customers if they're not on Amazon; there's no similar incentive to use Shopify.

Decelerating revenue growth

Another problem facing Shopify right now is decelerating revenue growth. Although 48% year-over-year growth is great, this is down from a growth rate of 60% not too long ago. With each passing quarter, Shopify's revenue growth decelerates a little bit, which makes the stratospheric valuation harder to justify.

Additionally, while this deceleration goes on, positive GAAP earnings remain nowhere in sight, which

calls into question whether the company is sincere about moving toward profitability. Throw equity dilution and a [\\$450 million acquisition](#) that's also losing money into the mix, and you've got a recipe for continued pain.

Slow cash flow growth

A final problem facing Shopify shareholders is slow growth in cash flow. Although Shopify's net operating cash flows are positive, they're crawling upward compared to revenue. In 2014, cash flows were negative to the tune of \$800,000, in 2018 they were positive to the tune of \$9.3 million. Over the very long term, cash flows are improving, but 2018's net cash flow was down from 2015 (when it was \$15.76 million), so the cash flow growth is overall a very mixed picture.

Foolish takeaway

Shopify has long been an expensive stock. Until recently, its valuation seemed easy to justify based on its similarity to Amazon and its strong revenue growth. Now that's looking less and less tenable. Shopify's revenue growth has been decelerating quite a bit recently, and its continued negative GAAP earnings and equity dilution are getting hard to justify. If you're looking for a hot tech stock, now might be the time to turn your eyes elsewhere.

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