Is it Time to Buy Shopify (TSX:SHOP) Stock?

Description

Shopify (TSX:SHOP)(NYSE:SHOP) stock is up 126% since the start of this year and a jaw-dropping 1,110% over the past five years. It's been Canada's most popular tech stock since the height of **BlackBerry**.

However, the stock tumbled in early trading today on account of missing analyst expectations for its third-quarter earnings.

According to its quarterly report published earlier today, the company generated $500 million in sales (up 45% from last year) and lost $0.38 per share in earnings. Analysts were expecting a profit.

Plenty of experts are now worried that the company has overshot its intrinsic value and could be priced to perfection. My Fool colleague Christopher Liew said investors were in a "trance" and the valuation was "over the top." After all, the stock trades at 27 times trailing 12-month revenue.

But with today's plunge, is it finally time to invest in Canada's most beloved tech star? The answer depends on two factors.

Shopify's cash flows

As I mentioned in my earlier article, hyper-growth technology companies seem to be deploying the same strategy. They raise external funds and spend it all on growth investments until they get to a stage where positive cash flows can help fund the growth internally. Eventually, the company turns profitable when the market opportunity is saturated.

Although Shopify did seek external funding this year, issuing 1.9 million new shares to raise about $600 million, the company also turned cash flow positive at the same time. Over the past 12 months, Shopify reported $13 million in free cash flow (FCF). This quarter, it reported negative FCF on account of higher investments in property and fulfillment centres.

However, the company now has US$2.67 billion in cash, cash equivalents, and marketable securities on its books, which should be sufficient to power growth for the foreseeable future.

Considering the fact that the global retail market is currently worth US$25 trillion in annual sales and e-commerce still represents only 15% of that market, I believe there's plenty of room for Shopify to expand.

The impact of competition

However, Shopify's path to growth and profitability isn't unobstructed. Plenty of competitors want a piece of the action and are willing to deploy immense capital to snatch the company's market share.

Adobe's acquisition and integration of the Magento platform earlier this year is particularly concerning. As is **Automattic's** WooCommerce and **Square's** Weebly. The largest threat to Shopify is, of course, **Amazon**.

However, Shopify's business plan is differentiated from Amazon, while its upcoming rollout of fulfillment centres could give it a competitive advantage over smaller e-commerce software-as-a-service providers. In other words, management has been clever in avoiding competition and is gradually creating a moat around the core business.

Bottom line

By raising hundreds of millions through the issuance of new shares recently, Shopify has expanded its runway for growth before it needs to become cash flow positive or profitable again. E-commerce is still an immense market opportunity, and Shopify has what it takes to conquer.

The recent dip in stock price could be an opportunity for long-term investors to add exposure here.

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