



Is Shopify (TSX:SHOP) Stock a Bubble Ready to Burst?

Description

Questioning a sudden jump in the value of a stock is something smart investors do when they see fundamentals not backing up the price action. In the Canadian market, one such stock that could fall in this category is e-commerce platform provider **Shopify** ([TSX:SHOP](#)) ([NYSE:SHOP](#)).

One of the most-loved tech stocks from Canada, [Shopify has surged](#) more than 170% in the past 12 months to trade at \$629 today. In the first five weeks of trading this year, Shopify is already up more than 20%. At this price, Shopify's market capitalization is touching \$73 billion, making it more valuable than **BCE**, the nation's largest telecom operator.

This price acceleration has been so fast and furious that Shopify stock's current value is more than three times higher than what analysts see the stock trading at in the next 12 months.

The rise of such magnitude is raising concerns in the minds of some investors, who are wondering whether Shopify stock is a bubble that's ready to burst. Let's first try to understand how bubbles in asset markets are formed.

A bubble is a run up in the price of an asset that is not justified by the fundamental supply-and-demand factors for the asset. Bubbles can occur in any traded commodity or financial instrument, such as stocks. Easy monetary policy is a common factor behind bubbles. In an environment when cheap credit is readily available, buyers use this money to buy for investment rather than use, causing prices to inflate.

Shopify stock: Reasons behind the price jump

But when you look at the factors that are fuelling gains in [Shopify's stock price](#), it's hard to relate the company with an asset price bubble. The company is at the centre of a major shift taking place in the market; consumers are shunning mortar-and-brick retail stores to buy online.

Shopify now boasts more than one million merchants on its platform — a number that has increased by 30% in just the last 12 months. Collectively, these merchants sold more than US\$15 billion worth of stuff in 40 countries through Shopify in the company's third quarter ended Sept. 30.

Many of these merchants are small- and medium-sized businesses, but some are big retailers as well, including **BBC, Gatorade, Gund and KKW Beauty**, a cosmetics company launched by Kim Kardashian West. Shopify is also expanding fast globally, as it serves customers in different languages and currencies.

That being said, Shopify's future revenue growth must justify the current market price of its stock; otherwise, this rally will fizzle out quickly. For now, Shopify is having success when it comes to satisfying growth-hungry investors. Sales in the third quarter increased 45% to US\$391 million from the same period a year ago. Analysts expect the company is on track to surpass US\$1.5 billion in sales for 2019, also up 45% from 2018.

But there are some risks that investors shouldn't ignore. For example, growth in year-over-year merchant solutions revenue has slowed to 50% from 68% in the third quarter of 2018, according to **RBC Dominion Securities**. Similarly, growth in subscription revenue has decelerated to 37% from 46% a year ago. The company is scheduled to release its Q4 financial results on Feb. 12.

Bottom line

Shopify stock's meteoric jump in the past one year has been backed by earnings momentum and the company's potential for future growth. But after that massive rally, its stock has become vulnerable to a correction, especially when there is too much cheap money chasing growth stocks and fuelling their prices.

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