



Why Shopify's (TSX:SHOP) Sky-High Valuation Doesn't Matter One Bit

Description

It's been a formula followed by Warren Buffett, Benjamin Graham, and countless other successful investors. Yes, I'm talking about value investing.

One of the interesting things about value investing is how much the practice has changed over the years. Walter Schloss — who just might be the [best investor you've never heard of](#) — delivered consistently excellent returns for more than 40 years doing nothing but buying statistically cheap stocks.

Schloss would buy at a rock-bottom price-to-book value or price-to-earnings ratio, hold until it normalized, and then book the profit. It wasn't just Schloss doing this either: Remember that Warren Buffett got his start doing the exact same thing.

Compare that to value investing now and it doesn't even look like the same activity. Value investing is no longer about buying statistically cheap stocks. A successful investor must look underneath the hood and figure out what makes a company special. As long as this sustainable competitive advantage is strong enough, the stock is a buy. Valuation no longer matters.

Many value investors refuse to accept this newfound reality. They continue to cling to outdated notions like the only good stock is a statistically cheap stock, causing many of these folks to miss out on some excellent long-term returns. It's been even worse than that for some value investors, as these folks have insisted on shorting some of these excellent stocks.

Shopify Inc. ([TSX:SHOP](#))([NYSE:SHOP](#)) is one of those names. Let's take a closer look at why this stock's valuation doesn't matter and why it's still a buy today despite a sky-high valuation.

Changing the world

If value investing today is all about having a sustainable competitive advantage, then Shopify easily qualifies. If you want to sell something online and host it at your own website, Shopify is the best option.

Yes, competition exists in this space, but most everyone who is serious about the [e-commerce sector](#)

agrees. Shopify has the gold standard software. The software is easiest to use, is reasonably priced, and Shopify's app store offers the most useful add-ons.

The company has also expanded into other verticals such as payment processing, financing for its customers, and operating warehouses in major cities to improve shipping times.

Just about every online merchant agrees: Shopify's services are a great value. Yet CEO Tobi Lutke and his team are resistant to increase prices despite almost certainly having the ability to do so. The company is all about growth right now. Profit is only an afterthought.

As long as the company breaks even or ekes out a small profit, everyone's happy. The business model is clearly successful, so raising cash isn't an issue, either.

According to analyst projections, Shopify should lose approximately \$0.10 per share in 2020 before swinging to a small profit in 2021. While that timeline may be accelerated a little bit because of the company's success during today's COVID-19 pandemic, the business plan remains the same. It's an intentional plan to sacrifice short-term profit for long-term market share.

Why Shopify is a different kind of investment

Essentially, it comes down to this: Shopify's valuation doesn't matter. Sentiment is what moves the stock today.

When investors think Shopify is changing the world, shares go up; when they believe something will bring down the stock, shares go down.

This is not unique to Shopify, of course. Every stock moves on sentiment to some degree. But I'd argue Shopify is one of the top sentiment stocks. After all, it doesn't really have a bottom valuation to fall back on.

All of this makes Shopify exceptionally difficult to forecast. And more important is that it makes it even harder to short. Remember, when you go long a stock, the downside is limited at 100% of your investment. But if you short, the downside risk is unlimited.

The bottom line on Shopify stock

Shopify is a wonderful company with loads of growth potential. In a world where most management teams are concerned about the next quarter, it's refreshing to see a company that thinks 5-10 years down the road.

This focus makes Shopify a unique investment opportunity. It also makes it difficult to predict the price of the stock. But if you can look past that, the company sure looks to be a winner over the long term.

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