



## Is Shopify (TSX:SHOP) Stock Finished?

### Description

Last week, we saw **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)) take a nosedive after several months of gains. In the span of just two days, the stock slid 15%, along with tech giants like **Apple** and **Tesla**. The move came after a summer that saw tech stocks rally to unprecedented heights. Prior to last week's selloff, the NASDAQ had hit several all-time highs, while SHOP itself was up 180% for the year.

In many ways, the tech selloff that sent SHOP sliding was predictable. As I [wrote in July](#), stocks that were seen as "COVID-proof" — including tech — had been getting expensive over the summer. With investors scrambling to get out of beaten-down sectors, money poured into stocks seen as immune to the pandemic. That made sense for a while, but eventually unrealistic valuations started to emerge. Last week, SHOP became a casualty of the overheated market.

The question now is whether SHOP can recover from the beating it took. While tech stocks in general have a lot of growth ahead of them, it would be hard for Shopify's fundamentals to catch up with its valuation. Even after last week's beating, it's still one of the most expensive stocks on the TSX. Assuming last quarter's beat was a fluke and the company will return to its previous revenue deceleration, then SHOP is decidedly overvalued. Let's take a closer look at those valuation metrics to see why that's the case.

### An extremely expensive stock

In the past 12 months, SHOP has done about \$2.1 billion in revenue. That gives the stock a 60 price-to-sales ratio at \$1,270. The stock does not have a positive P/E ratio for the trailing 12-month period — at least going off GAAP earnings. However, various financial data providers give estimated forward P/E ratios between 299 and 476. The stock's price-to-book ratio is about 33.

These are all extremely steep valuation metrics. Basically, they mean that when you buy SHOP, you're paying a heavy premium for the earnings and assets you're getting.

Of course, we expect young tech companies to be expensive relative to earnings. But when a stock trades at 60 times sales, you're basically betting on a *lot* of sustained growth, for a long time, when you

buy it. It's far from guaranteed that SHOP's fundamentals will catch up with the steep price the markets give it. That certainly *could* happen, but the growth required would be significant.

## A solid quarter

With all the above being said, SHOP undeniably had a solid second quarter. In it, the company grew revenue by 97% year over year and posted positive GAAP earnings. The GAAP net income figure was [\\$36 million](#), or \$0.29 per diluted share. While the company had been posting positive adjusted earnings for a while, this was its first time pulling it off in GAAP terms.

In Q2, Shopify benefitted heavily from the closure of retail businesses due to COVID-19. With retailers shut down, many consumers opted to shop online. That led to a huge sales spike for Shopify. So, the company's next quarter will be one to watch. We really need to see whether this company can continue its growth post-COVID to know whether it's worth buying at today's prices. The current valuation comes after an overly strong quarter with major tailwinds, that may not be replicated in the future.

So to get back to the main question, is Shopify finished?

The answer ultimately depends on your time horizon. The underlying company certainly isn't down for the count, but the stock itself is due for a near-term correction. You'd be well advised to proceed with caution if you plan to buy it in September.

### CATEGORY

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2. Tech Stocks

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2. TSX:SHOP (Shopify Inc.)

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