Why Did Shopify (TSX:SHOP) Drop After Earnings?

Description

E-commerce giant **Shopify** (TSX:SHOP)(NYSE:SHOP) reported fourth-quarter earnings yesterday. As expected, the numbers were stellar. However, SHOP stock dropped roughly 7%. Canada's most impressive tech company seems to have underwhelmed investors this time.

Here are three reasons the stock dropped and why investors should further temper their expectations for the months ahead.

Shopify's stock valuation

At this point, the fact that Shopify stock is trading at 60 times sales should come as no surprise to anyone. That ratio isn't just higher than Shopify's historic average; it's also higher than most other e-commerce firms.

Bullish investors would argue the company's remarkable growth rate means it will eventually grow into this valuation. Global online retail, after all, is a multi-trillion-dollar opportunity. However, that would imply that the stock is priced to perfection based on extrapolating current growth rates.

However, in its latest earnings report, the company admitted that future growth rates could be lower than the previous year.

Growth slowdown

Over the course of 2020, Shopify's revenue expanded a jaw-dropping 86% to $3.7 billion. While management expects double-digit growth in 2021 too, they admitted that the rate could be lower than 86%.

This slowdown is driven, ironically, by the economic recovery. As shops and malls open across North America, online shopping could see a dip. If the global vaccine rollout continues at its current pace, the upcoming Christmas season could be a noticeably “normal” one. Couple that with the fact that governments will eventually pull their stimulus programs and you can see why Shopify’s growth this year could be subdued.

In short, Shopify stock is pricing in growth that may fall short of expectations. Another factor that could dash expectations is competition from Amazon’s biggest rival: **Amazon**.

Amazon’s move

The world’s largest e-commerce firm recently acquired Selz, a startup that helps small businesses set up online shops. In other words, Shopify now has a target on its back.

Tech investors know how relentless Amazon can be. If this recent acquisition is an indication that Amazon could cannibalize some Shopify sales, the stock’s valuation may have to be adjusted further.

Amazon’s strategic move makes sense. Eventually, the company had to address the fact that it was losing some merchants to Shopify. This acquisition isn’t an experiment. It’s a necessity for Amazon if it wants to retain its crown as the undisputed king of online shopping.

Bottom line

The risks are piling up. Shopify faces a subdued year ahead. The economic recovery and pullback in stimulus programs could slow down online shoppers. Meanwhile, Amazon’s entry into the sector could magnify Shopify’s risks.

However, the stock hasn’t priced any of these risks or worries yet. It’s still trading near an all-time high. The price-to-sales ratio indicates investor euphoria. If you’re a shareholder, this could be the right time to take some profits off the table.

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