Why Shopify Stock Dropped 3% Yesterday

Description

On Wednesday, **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP) reported earnings. Its stock fell as much as 7% in early trading before recovering near the end of the day.

Today I'm going to discuss why this stock dropped so sharply, and why this earnings report matters for investors.

Earnings growth expected to slow in 2021

The biggest takeaway from Shopify's earnings report were comments made by the company that indicated growth in 2021 would not be as good as what was seen in 2020.

That might be expected. After all, 2020 was an absolutely incredible year. "The year of the pandemic" provided accelerated e-commerce growth not many analysts had initially predicted. On the outset of the coronavirus pandemic, expectations were that SME bankruptcies might provide a headwind for Shopify. However, the e-commerce platform provider reported revenue growth of 86% year over year.

The reasons for this slower growth rate this year?

First, Shopify expects a rapid vaccine rollout to result in a return to bricks-and-mortar shopping. Many shopaholics are eager to get back into the mall, preferably without having to wear a mask. If we see a return to normal (or even semi-normal), it's conceivable e-commerce shopping will take a hit.

Second, the company announced it may not be as aggressive with entering new markets as expected. Shopify's management team indicated that it may not be "the right time to go really deep" into countries it has on its radar. Rather, expansions to new markets may happen further down the road.

So how were the numbers?

Shopify reported fourth quarter adjusted earnings of US$1.58 per share, handily beating expectations of US.$1.21 per share. The company's fourth quarter revenue came in just shy of $1 billion, almost doubling last year's fourth quarter. Additionally, gross merchandize value (the volume of goods flowing through Shopify's e-commerce platform) doubled last year's total to more than US$41 billion.

These numbers were excellent. Shopify beat earnings expectations, yet again. One would think a positive earnings surprise would be in the cards. However, the aforementioned comments with respect to forward-looking growth have dampened investors' outlook.

Bottom line

Shopify is a world-class company absolutely dominating its sector. This company's growth thus far has far exceeded what many investors thought was possible a few years ago.

However, the bar is continuously raised each and every earnings beat. Investors continue to expect a year-over-year doubling of revenue from this company. Whether or not that's sustainable for any extended period remains to be seen. These comments have suggested the company's management team is skeptical of such an idea.

There was likely some profit-taking yesterday, which is understandable. Given how high expectations were coming into this earnings report, any sort of inkling of reduced growth was prone to induce a sell-off.

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