Why Shopify (TSX:SHOP) Stock Slumped 22% in a Month

Description

Shopify (TSX:SHOP)(NYSE:SHOP), the most valued TSX stock of 2020, underperformed the market in 12 months. Shopify surged 8% compared to the TSX Composite Index, which surged 18.7%. The stock slumped 22% in 30 days when it was supposed to ride the Santa Claus rally. What can you say? The stock market is full of surprises, and it is this uncertainty that leads to volatility, risks, and rewards.

The importance of knowing the why

Just accepting the uncertainty doesn't answer the question of why Shopify stock fell. Knowing why is important, as it tells you whether the dip is here to stay or if it is just cyclical. Knowing this helps you decide whether to buy the dip or sell the stock and book profit or loss, depending on your cost per share.

If the current dip is cyclical, it is the right time to buy the dip. But if the dip is here to stay for a longer time, it is better to book some profit and invest that money where growth is visible. Which of the two is the case for Shopify?

Shopify after the pandemic catalyst

The last two months of the year are seasonally strong for the e-commerce giant, as it sees a surge in order volumes thanks to holiday shopping. But this time, rising inflation, supply chain issues, and now the Omicron variant has impacted Christmas spending. Things are getting expensive, and people don't have enough purchasing power to splurge on expensive gifts. Moreover, the Omicron variant has raised fears among consumers, and they are saving up for the worst.

In 2020, Shopify was a key beneficiary of the pandemic, as all the brick-and-mortar store traffic moved to online stores. Even grocers opened a Shopify store. All this enthusiasm doubled Shopify's revenue, and investors priced this growth in the stock. Hence, Shopify stock surged 190% from the March 2020 dip to $1,437 at the end of December 2020. This surge inflated its valuation, with a price-to-sales (P/S) ratio of 47. This valuation has priced the 86% revenue growth and 96% gross merchandise volume

(GMV) growth of 2020.

But this growth normalized in 2021. In the third quarter ended September 2021, Shopify's revenue and GMV grew 46% and 35%, respectively. But this did not dampen investor optimism. Shopify stock surged 29% between October 4 and November 19 on the back of the Santa Claus rally, as the company earns most of its revenue during this time of the year.

Why did Shopify stock fall over 20% in a month?

Trading at a P/S ratio of 50.75, a lot of expectation was tied to Shopify stock. Hence, any negative news can have a cascading effect on this overvalued stock. The Omicron spread cast a bear shadow on the global stock market, and all overvalued stocks came tumbling down. This time, Shopify stock could not dodge the bears and fell 22% in the Omicron wave (November 19 – December 20) and is now trading at a 44 times P/S ratio.

This dip is not cyclical. It has got me worried as this dip has reversed Shopify's contrarian move. Instead of rallying in a pandemic wave, it is falling like all other stocks. Does this mark the end of the pandemic catalyst? Has the stock reached its upper limit? Only time will tell.

Shopify has a bright outlook, with Wall Street projecting an average annual revenue growth rate of 41% in the 2020-2025 period. But investors have already priced in this expectation. I do not expect the stock to surge past $2,000 (13% upside) and maintain that price for long. However, the stock has a steeper downside if it fails to meet expectations.

Final thoughts

Shopify stock has moved from a high-growth stock to a large-cap stock with limited growth. You can continue holding the stock for the long term and ignore 15-20% dips and rallies in the short term. Or you can book some profit and invest it in a high-growth e-commerce stock like **Lightspeed Commerce**, which is trading at a 65% discount because of a short-seller attack.

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