Alert: Shopify Earnings Tomorrow Could Be Disappointing

Description

Canada's most famous growth stock is having a bad year. **Shopify** (TSX:SHOP)(NYSE:SHOP) stock is down 36.7% year to date. It's down 49% from its all-time high in November 2021. The e-commerce giant reports earnings tomorrow morning. Here's why the report could disappoint analysts and push the stock lower.

While quarterly earnings are notoriously difficult to predict, here are a few reasons I'm concerned about tomorrow's report.

Digital advertising

Tim Cook's focus on privacy features for iOS devices has created an issue for digital advertisers. With less access to personal data, online advertising is increasingly expensive and less effective than it used to be. While this is good news for personal privacy, it's bad news for small- and medium-sized businesses that relied on these advertising tools to reach their customers.

Most Shopify merchants are small or medium sized. Search and social media advertising was an integral part of their business model. Now that this tool has been blunted, their ability to expand sales could be impacted.

Sales slowdown

Shopify was predicting a slowdown in sales, even before the privacy measures were introduced. In early 2021, the management team lowered its forecast for full-year sales. The reason for this was base effects. In other words, sales were so high in 2020, that matching this pace in 2021 would be exceedingly difficult.

Tomorrow, the company reports its fourth-quarter earnings. This is the crucial Christmas holiday shopping season. There's a good chance Shopify sold more merchandise in 2021 than it did in 2020. However, the rate of change may have slowed down dramatically. For context, the company's quarterly growth rate was above 90% during the pandemic. Now, with retail locations reopening and government stimulus measures rolled back, that rate would be difficult to achieve.

A normalization of growth rates isn't bad. However, Shopify's valuation is less justified when sales growth is slowing down.

Valuation

During the market peak, Shopify's price-to-sales (P/S) ratio exceeded 60. That valuation may have been justified when sales were growing at 90% to 100% a year. But now, a slower growth rate means the valuation needs to adjust as well.

At the time of writing, Shopify stock is trading at a P/S ratio of 25.3. That's significantly lower than its market peak. In fact, the ratio is back to its pre-pandemic levels. However, it's still higher than other large, mature e-commerce companies. If Shopify has turned into a mature tech firm, the ratio would need to dive lower.

Outlook

Despite these concerns, I'm optimistic about Shopify's long-term future. The company's recent foray into digital assets and online payments is encouraging. Meanwhile, disappointing results could push the valuation down to more attractive levels. In other words, it could be a buying opportunity for investors willing to be patient.

Bottom line

Shopify reports earnings tomorrow morning. This highly anticipated report could indicate a slowdown in sales growth and a lukewarm outlook for the next few quarters. However, if the stock's valuation adjusts accordingly, it could be an opportunity to add exposure. Keep an eye out for more details.

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