Shopify (TSX:SHOP): Too Early to Bottom Fish?

Description

Shopify (TSX:SHOP)(NYSE:SHOP) stock is starting to see its relief rally fade, with the stock recently pulling back towards that $800-per-share mark once again. Now off around 13% from its recent multi-week peak, the question investors need to ask themselves is whether those March depths will be tested over the coming weeks.

With rates continuing to climb, it's arguable that Shopify stock should be worth less than it was during the local bottom back in March. Higher rates are worse for high-multiple growers like Shopify that may see a majority of their profits way out into the future. We've witnessed more than our fair share of growth-focused selloffs in recent years.

Although it's impossible to tell if the recent bounce in growth is nothing more than a bear market rally that should reward "selling the rip" as opposed to "buying the dip," I think investors should be careful when it comes to high-multiple growth stocks as a whole.

Shopify stock: All about those rates

Shopify stock is the best in its breed, but its hefty valuation has not spared it from the rate-induced selling pressure. As central banks begin to tighten to push inflation towards the more manageable 3% levels, I fear that a further upside surprise in the 10-year note could bring forth another wave of vicious selling.

As great a company as Shopify is, it's still not cheap at around 18-20 times sales. I think the days of paying for high price-to-sales (P/S) stocks are all but over. However, I could be wrong if rates take an unexpected turn lower.

What price could Shopify finally stage some sort of bottom?

I think Shopify stock is worth a big premium over the peer group. There's no question about that. It has brilliant managers and a massive TAM (total addressable market) that's yet to be captured. If anything, the TAM is growing, with Shopify breaking into payments and other intriguing categories that could bolster sales and future profitability.

The metaverse and rise of augmented reality could take another step out of physical retailers and add another tailwind to the e-commerce firms. Shopify could be responsible for the future digital stores of tomorrow, and if it is, it’s really hard to imagine the type of profits the firm is capable of down the road.

For now, Shopify’s growth stories will be less material to the stock. Sales growth matters but not nearly as much as margin expansion and earnings growth. Eventually, we’ll reach a point where Shopify will have the bar lowered such that even sales growth (and long-term guidance) will be able to propel shares higher again. I don’t think we’re there yet at around $800 and change per share.

Personally, I would nibble SHOP stock on the way down at key support levels — the next two being at around $700 and $500 per share. Yes, that’s a far cry away from where we’re at today, but as recession fears and higher rates intensify further, such an entry point isn’t all that far-fetched. In fact, I’d argue that 2020 lows are more than within reach, given so many other growth stocks have already fallen to or below such levels.

The bottom line on SHOP stock

Shopify stock’s fundamentals have not changed drastically. It’s mostly the price that’s faltered. But there’s a good reason behind the valuation reset. Shopify stock traded at insanely high multiples at its peak north of $2,000 per share.

At 40 or 50 times sales, the stock was the victim of the euphoric frenzy of 2020. Now, the stock is trying to find the floor after a vicious valuation reset that’s either over with or is taking a breather. But once the dust settles, I think Shopify stock is one of few names that will recover from its vicious selloff. It could have more room to the downside over the medium term, though, so be ready to average down if you’re looking to take advantage of the recent crash in the name.

Personally, the $500 level is where I’m looking to initiate a position. Whether or not it gets there, though, will depend on rates and the fate of the economy as central banks raise rates.

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Date
2025/07/06
Date Created
2022/04/10
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