Shopify's (TSX:SHOP) 2022 Outlook: Should You Be Worried?

Description

If you purchased **Shopify** (TSX:SHOP)(NYSE:SHOP) stock in 2021, you have probably lost 70-80% value. Even if you purchased the stock in the early days of pandemic recovery, you are sitting on a 50% loss. Many shareholders still in the money are the ones who purchased the stock before 2019. Shopify's latest earnings hint that more downside is in the cards, as e-commerce and retail sectors feel the effects of inflation and recession.

Shopify's second-quarter earnings

The last few days were another adventure for Shopify investors, as the company announced a 10% workforce reduction ahead of reporting the weakest revenue growth since it went public. Shopify's revenue rose 16% year over year to US$1.3 billion — its weakest growth since 2014. This revenue growth could probably slow to single digits in the second half of the year.

Multiple factors are at play behind the weakness:

- The 2021 base year has a record revenue from the pandemic. In 2021, many analysts said Shopify is seeing 10-year growth in a single year. As the pandemic effect subsides, and e-commerce returns to pre-COVID levels, slower growth was expected.
- The revenue growth rate slowed 1.5 percentage points as the U.S. dollar strengthened. Shopify reports revenue in U.S. dollars. Hence, revenue outside the United States when converted into U.S. dollars reduces the absolute amount.
- The overall consumer demand has slowed, as high gasoline and food prices shift demand away from luxury goods.
- People have returned to buying from brick-and-mortar stores, as the pandemic-driven lockdown ended.

As the United States and Canadian economy head toward a recession, Shopify has revised its outlook.

2022 outlook

> "We now expect 2022 will end up being different, more of a transition year, in which e-commerce has largely reset to the pre-COVID trend line and is now pressured by persistently high inflation."
> *Shopify's press release*

The second half is seasonally strong for Shopify, as it sees Black Friday and other holiday sales. But this time, Shopify expects the second half revenue to be similar to the first half. It reported an adjusted operating loss of US$41.8 million (3% of revenue) in the second quarter, which is the opposite of an adjusted operating income of $236.8 million (21% of revenue) in the previous year's quarter. For the second half of 2022, it expects operating loss to widen due to a higher mix of merchant solutions revenue that generates lower profit margins.

Shopify has US$ 7 billion in cash reserves that can fund its losses. But it is not enough. A recession brings structural changes to the business environment. Industries consolidate. Many companies lose significant market share after a recession ends. Only those who succeed in keeping their brand relevant during the recession and tap the recovery turn out to be market leaders.

Shopify grew handsomely in a favourable economy. But it remains to be seen if it can thrive and stand out from competitors in an unfavourable economy.

Should you be concerned about your Shopify holdings?

These are uncertain times, and Shopify stock has lost 79% of its value. Increasing losses and slowing revenue throughout 2022 could create more downside. Its current valuation of 10.97 times enterprise value-to-revenue (EVR) is expensive. The EVR multiple tells you the amount you are paying to purchase a company in terms of sales. **Lightspeed Commerce** stock is trading at half the multiple.

Shopify announced a 10-1 stock split to make its shares affordable to retail investors, as the 2021 tech bubble inflated its share price. In this inflationary environment, a retail investor would be skeptical about buying a high-risk stock worth $400. But the split didn't encourage investors to buy the stock.

I expect more downside for Shopify stock throughout 2022, as it faces the double blow of a tech bubble burst and a recession. The stock may not reach the 2021 high for a very long time, as it happened with most tech stocks after the 2000 dot.com bubble burst.

If you have been holding Shopify stock, you could sell the stock when it shows some growth. Instead of Shopify stock, you can buy the **iShares S&P/TSX Capped Information Technology Index** ETF, which has holdings in Shopify and other tech stocks, to mitigate your downside risk.

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3. TSX:LSPD (Lightspeed Commerce)
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Date
2025/08/14
Date Created
2022/07/28
Author
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