3 Things to Know About Shopify Stock After Earnings

Description

Shopify (TSX:SHOP) is a leading e-commerce platform designed for small- and medium-sized businesses. Shopify's recent earnings report sent its stock price soaring yesterday, and it provides valuable insight into the company. Here are the three most important points.

Gross merchandise volume (GMV) growth slowing but still above 10%

As per Shopify's management, the macro environment is placing some stress on Shopify's business. In fact, businesses are dealing with rising interest rates and inflation. Also, consumers are dealing with the same. This is showing up in trends such as a consumer preference for discount retailers as well as a simple reduction in discretionary spending. It's playing out as expected and is no cause for alarm in and of itself.

GMV represents the total value of orders facilitated through the Shopify platform. It's the pulse of Shopify's business. Last quarter, GMV increased 11%, This is by no means the growth rates that Shopify saw in prior years, but two things are noteworthy here. Firstly, the comparisons are based on a much higher base, that is, $25 billion this quarter versus $20.5 billion a year ago. So, naturally, growth rates diminish over time if only for this simple fact. But it's okay because it means the business is growing, as we want it to.

Secondly, while the 11% growth rate pales in comparison to last year's 35% growth rate, it's still growing at double digits. The pandemic years were artificially high due to lockdowns. In fact, the company always said that those elevated growth rates were a temporary thing. The e-commerce trend was accelerated by years because of the pandemic. Shopify would not be a company with $4.6 billion in annual sales today without it.

Shopify stock is vulnerable to additional risks

One thing that really stood out to me is Shopify Capital, which launched in Australia during the quarter and is now available in four countries. While funding its small business owners is really a great extension for a company like Shopify, I wonder if the risks are fully accounted for.

By its own admission, it’s loaning money to businesses that traditional banks are pretty skittish to lend money to. This brings a lot of additional risk into the Shopify equation. Even at the best of times, small businesses are a risky proposition. Today, they’re even more so. Because clearly, the macroeconomic environment is deteriorating. Rising interest rates and inflation are eating away at businesses. Surely, one can imagine that the risk of default is high and rising.

So, while I like the idea of Shopify helping out its merchants with capital, it also makes me nervous. It can support a merchant, which would ultimately translate into revenues for Shopify, but things can also go wrong. In the third quarter, merchants received $507.6 million in cash advances and loans from Shopify Capital, which has grown to $4.3 billion in cumulative capital funded.

The losses continue, putting SHOP stock at risk

One of the problems that remains with Shopify is that the losses keep mounting. 2022 has seen the return of operating and net losses after the profitable pandemic years. But time keeps marching on, and margins are getting hit. For example, the gross margin was 50% versus 55% last year. Also, the company has swung to a large operating loss as research and development expenses as well as selling, marketing, and administrative expenses are skyrocketing.

In a situation like this, the next logical step is to evaluate the balance sheet. Shopify currently has $6.9 billion of cash and cash equivalents on its balance sheet. That’s a lot. But let’s dig a little deeper. Last quarter, Shopify’s operating cash flow was a negative $200 million. At that rate, Shopify’s cash would last a long time — roughly eight years.

So, the situation is not dire right now, but consider this: a weakening consumer could wreak havoc on Shopify’s earnings and Shopify stock, both in lower merchant revenue and in defaults on Shopify’s loans. The company still has a lot of investment ahead, and this, combined with a weakened consumer, spells trouble. Lastly, Shopify’s stock price remains expensive, trading at a price-to-sales ratio of almost eight times.

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Date
2025/09/09
Date Created
2022/10/29
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