Down 77% in the Bearish Market, Can Shopify Ever Recover to its All-Time Highs?

Description

Shopify (TSX:SHOP) stock has taken a beating over the last year and a half. Down 77% from the November high ($213.98), it has underperformed when compared to the average stock. In fact, it has underperformed compared to other tech stocks, which, as a group, have underperformed the markets. From top to bottom, the NASDAQ-100 has fallen 33%, Shopify's percentage decline has been more than double that.

For the investor of yesterday, it has been a tough time. A person buying Shopify today might feel optimistic about getting a modest return, but what about the person who bought in at the all-time high? Will such a person ever break even? In this article, I will attempt to determine whether that is possible.

What would it take for Shopify to get back to its all-time high?

Shopify stock trades for about $49 (as of Wednesday's close, when this article was written). Its all-time high, as previously mentioned, was $213.98. To return to its all-time high, SHOP would need to deliver a 336% return.

That is certainly within the realm of possibility in the stock market, but it is not the norm. Over the past decade, the S&P 500 has delivered a 12.5% annualized return with dividends included. Shopify itself has delivered a 39% annualized return. At its all-time high, Shopify was sitting on a 100% annualized return! Certainly, if SHOP got back to its old growth rates, then it would have the potential to get back to $213.98. However, there are some barriers to Shopify actually achieving such growth rates, as I'll show in the next section.

Why that might not happen

One of the reasons why Shopify might not re-take its all-time high *quickly* is because growth in the business itself has slowed down. Stocks are valued based on the performance of the business that issues them. If a profitable company turns unprofitable, or if a fast-growing company's growth slows down, then the market demands a lower stock price.

At its all-time high, Shopify stock had a very high price-to-sales ratio. The peak level was about 60, which means that each dollar invested into the stock owned $0.016 worth of revenue, which would take 60 years to equal the dollar invested into the company. The ratio of price-to-earnings was even higher!

The reason why Shopify was valued so richly is because it was growing quickly. In 2020, Shopify's revenue was growing at 86% year over year. If you can expect revenue to keep growing that quickly, then a high price-to-sales ratio isn't such a big deal: the ratio will go lower in due time. However, the problem is that Shopify's growth slowed down a lot. In the second-most recent quarter, it fell to 16%! That is nowhere near the kind of growth rate you need to justify a 60 times sales ratio.

Another problem is that technology companies like Shopify "pulled growth forward" during the COVID-19 pandemic — e-commerce companies especially. When retail stores closed down, online stores picked up the slack, resulting in a surge in sales in 2020 and 2021. Unfortunately, the sales spurt reversed when the lockdowns ended, creating a situation where, basically, several years' worth of growth was realized in 2020. It will take a long time for Shopify to start growing at 2020 rates again — assuming it's even possible.

So, is Shopify a decent buy today?

If you're just buying in for the first time, possibly, yes. The stock is nowhere near as expensive as it once was, and its growth is still above average. But if you bought at $200, it might be a while before you break even.

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