

Buy Shopify

Karl Thiel | February 24, 2016 | [Buy Recommendation](#)

CURRENT PRICE: [SHOP](#) \$ 916.32 ↑ \$ 19.32 (2.2%)

Tobias Lütke was a programming prodigy with a taste for adventure and business, and all three of those things came together in his early 20s when he launched an online snowboarding-gear store with a friend. But there was a fairly fundamental problem: Even with his advanced skills, Lütke couldn't find a simple e-commerce platform that could be adapted to different sales channels or accommodate a growing business. So he created his own solution — and it quickly became much bigger than snowboards.

Today, **Shopify** ([NYSE: SHOP](#)) serves more than 243,000 small to medium-sized businesses (SMBs), in over 150 countries, looking for the same ease and flexibility Lütke was when he started out. Not bad for 12 years' work — but not close to the millions of clients the company believes it can reach. Shopify's model is getting buy-in from Internet heavyweights as well as the small fry, and we think it won't be long until today's price for this rising star in e-commerce looks like a discount.

Selling the Business

Lütke says Shopify's genesis was "probably the first time in history of our industry that someone who actually ran a retail business has actually been involved in the creation of software for a retail business." That may be a little tongue-in-cheek, but it also explains why Shopify solves the very problems Lütke ran into as a retailer.

In public, Shopify lets users sell their goods just about anywhere they want to. Merchants can set up a custom storefront whether they're on a standalone website or selling through **Amazon.com**'s ([NASDAQ: AMZN](#)) Marketplace or **eBay** ([NASDAQ: EBAY](#)). But they can also post a "buy" button pretty much anywhere they want on social media — whether it's a blog, Pinterest, **Facebook** ([NASDAQ: FB](#)), **Twitter** ([NYSE: TWTR](#)), they're in business.

Meanwhile, behind the scenes, Shopify lets its clients support multiple sales channels, monitor inventory, process payments, manage customer relationships (including search engine optimization and social media), and run business analytics. If they have a brick-and-mortar store and want to use point-of-sale software, that's part of the platform too. And the whole package, more or less, can be controlled from a mobile phone.

All its shop owners pay a monthly subscription fee — ranging from \$9 to \$179 — plus a transaction fee for each sale. And now there's Shopify Plus for larger companies seeking an unlimited, cloud-based, fully hosted platform without transaction fees — priced at up to \$5,000 a month. Approximately equal to the company's subscription revenue is the money it makes from its Merchant Solutions business. That includes payments (which scales with the gross merchandise volume flowing through the platform), shipments (merchants can print USPS labels directly from Shopify), and point-of-service hardware.

WHAT IT DOES

Shopify is an e-commerce and payment platform for small to medium-sized businesses, with over 243,000 merchants.

WHY BUY

- Its fast-growing e-commerce platform serves customers "from cradle to scale" and gets strong positive reviews.
- Shopify is a preferred platform for Amazon.com, Facebook, Twitter, and Pinterest.
- Highly visible recurring revenue is growing rapidly as new subscribers join, while transaction volume drives further growth.

KEY DATA

- **Headquarters:** Ottawa, Ontario
- **Website:** [www.shopify.ca](#)
- **Sign of a Breaker:** Top Dog
- **Market Cap:** \$1,653
- **Cash/Debt:** \$192 / \$0
- **Revenue (TTM):** \$205
- **Earnings (TTM):** (\$19)
- **Revenue (2012/'13/'14):** \$24 / \$50 / \$105
- **Earnings (2012/'13/'14):** (\$1) / (\$5) / (\$22)
- **Recent Price:** \$20.57

BUYER'S GUIDE

- **Industry:** Software
- **Size:** Small Cap
- **Region:** Global
- **Risk:** 11 out of 25 ([see all our stocks here](#))
- **Crushability:** Coconut ([see the full scale here](#))
- **Most similar to:** Salesforce.com, Zendesk

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Dollar amounts are in millions (except recent price)

Data as of Feb. 19, 2016

Other e-commerce platforms have benefited from inertia — once you're committed, it's hard to switch. Shopify's customers stay not because it's too hard to leave but because they love what they're getting. The platform gets consistently positive reviews from retail how-to sites, and the company's own measure of retention — its Monthly Billings Retention Rate, which looks at the billings of a cohort of merchants from one month versus the prior — is over 100%.

Wait, Hasn't Someone Done This Already?

Certainly Shopify isn't the first company to try its hand at a better tool for online merchants. Amazon, for instance, had its Webstore platform. But Amazon gave Shopify big-time validation back in September by announcing it would no longer be using its own software for its Webstores — it would go with Shopify's. The user experience is seamless — merchants' items are cross-listed on Amazon Marketplace, but they can still use Amazon for login, payment, fulfillment, and so on. Shoppers don't realize it's actually Shopify powering the back end.

The experience has been similar with Facebook: The "Buy" button that the social network started rolling out in July is actually the product of a development partnership with Shopify, which provides all the back-end power behind the simple interface. If you want to sell directly on Facebook, at least for now, you'll need a Shopify account. The company has similar deals with Twitter and Pinterest.

To be clear, Shopify's deal with Twitter is not exclusive — stores powered by competitors **Demandware** ([NYSE: DWRE](#)) and Bigcommerce can also post Buy buttons on the platform. And while its deal with Facebook appears to be exclusive for the time being, it's not clear that this is part of the agreement — Facebook may eventually expand its shops to other platforms.

Still, these partnerships have only begun to move the needle for Shopify. (If you're anything like me, you may be thinking "what Facebook 'Buy' button?") The social media platforms have been cautious in rolling out these shopping options. Yet that may be a coiled spring ready to pop as more advertisers try to reduce friction for shoppers and lose fewer leads.

Opening Time

Even with these new growth initiatives at their earliest stages, Shopify is doing great business. Indeed, the upside looks virtually unlimited at this point. In 2015, the company processed \$7.7 billion in gross merchandise volume across its platform — \$2.8 billion in the fourth quarter alone. But that's not even a drop in the bucket against the estimated \$1.7 trillion in online sales that took place last year.

The company's revenue has essentially doubled every year since it started reporting figures (it was up 95.4% in 2015 to \$205.2 million), with Merchant Solutions (i.e., payments and shipping) growing particularly quickly. Subscriptions were up 70% in the most recent quarter, with monthly recurring payments (number of merchants with a subscription times the average subscription fee) rising to \$11.3 million. But Merchant Solutions was up 140%.

The company originally said it was pursuing 10 million merchants with fewer than 500 employees in its core geographies, but it is likely to keep raising its ambitions as its clientele grows. Still, assuming it grows its merchant base 30% a year for the next five years, that gets Shopify to about 900,000 by 2020 — still a small way to its ultimate goal. Even if we assume nothing else about the company improves — it continues to get about the same average revenue per subscriber per month and Merchant Solutions continues to approximately equal subscriptions, with no new source of revenue — that puts the top line over \$1 billion, with EBITDA likely to run around \$120 million. With a current market cap of about \$1.7 billion, the company should certainly grow into its valuation. But there's huge potential upside to this target, as well as growth that should last for an extraordinarily long period.

Risks and When We'd Sell

The company is not profitable at this stage, although it had positive operating cash flow last year. That certainly opens up it and its stock to more investor concern — and volatility. And since it's priced with the expectation of strong growth, any stumbles are likely to be treated harshly. In fact, we've seen volatility even when the business is hitting on all cylinders: This company had been a momentum darling since its May 2015 IPO, and we've been watching it, admiring the company and its progress, but also concerned about its short-term price. But now that that price has come down over 50% from its peak, we think it's too good to pass up — the business, after all, keeps improving, and it is priced for a performance we think the company can handily exceed.

Still, the company has competitors, from those focused more on large enterprise clients (like Bigcommerce) to those going after that same SMBs that are Shopify's bread and butter (like Volusion). If Shopify fails to outpace them — or to keep its favored status with key channels like Amazon, Facebook, Twitter, and Pinterest — we could see shares discounted further.

Also, be aware that voting power is concentrated in Class B shares, which have 10 votes apiece, unlike the ordinary Class A shares available to retail investors. Thus, the approximately 11.1% of the company that Lütke owns effectively keeps decision-making with him. We don't necessarily mind this situation, particularly if it gives management freedom to make good long-term decisions instead of pleasing Wall Street quarter to quarter. But Lütke is less of a known quantity than the owners of similarly structured companies like, say, **Alphabet** ([NASDAQ: GOOGL](#)).

The Foolish Bottom Line

Shopify talks about going "from cradle to scale," meaning it provides an affordable platform for entrepreneurs just starting out, selling maybe a dozen items a month and managing the business "on their lunch hour," yet it can scale the same platform all the way up to \$100 million operations. It's a business somewhat reminiscent of what **Salesforce.com** ([NYSE: CRM](#)) did in customer relationship management: Shopify has built something streamlined, cloud-based, and scalable, and started off at the low end of the market while it builds capabilities and a legion of fans. It's already convinced the likes of Amazon that it's not worth reinventing the wheel; we think it will continue to sway a legion of SMBs looking to reach new customers.



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