

# Buy Shopify

Karl Thiel | March 23, 2016 | [Buy Recommendation](#)

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

**This is the second time we've recommended Shopify!** When we re-recommend a stock, it's a sign of extra confidence in a company we already know well. While we don't advocate buying too much of any stock, we think you should give this one a longer look as you build a well-diversified portfolio of 15 or more stocks to own for at least 3-5 years.

It's not exactly a two-for-one sale, but it still looks like a bargain to us. For the second month in a row, we're recommending you add **Shopify** ([NYSE: SHOP](#)) to your cart.

The online sales platform's stock is off to a strong start for members who bought last month, up 20% in just a few weeks. Part of the reason for the surge is a recent upgrade from Pacific Crest Securities that laid out how the company has become more attractive in terms of competition, margins, and price. We discussed much of that last month, and [my original write-up](#) is a good place to dig into our thesis if you haven't already.

But we're back for more this month because we believe in Shopify's opportunity to transform how entrepreneurs launch and grow their businesses online, and we want to emphasize that the quick gains we've enjoyed in the past few weeks are a far cry from the stock's true potential. (Just ask **Alphabet** ([NASDAQ: GOOGL](#)), which is rumored to be considering a buyout.) This month, I'll get into some of the reasons I think Shopify's business continues to improve and drill down a bit further on how it's disrupting its rather large niche.

## Just Say 'Shopify'

Shopify's e-commerce platform was created by a founder who combined programming talent and retail savvy (Tobias Lütke, now the CEO). As a result, it's both sticky and scalable.

As CFO Russell Norman Jones explained at an investor conference earlier this month, "Our fundamental belief is that 80% of what everyone needs is going to be part of the core product. The rest you can do through apps." And with well over 1,000 apps, this is a significant competitive advantage for the company. Pretty much however you want to customize your Shopify store or link it to other systems and services, you can do that. Apps let you integrate with Quickbooks or Xero or Mailchimp; they let users personalize their products, create loyalty and affiliate programs, survey customers, embed customer reviews, offer live chat customer service, and much more. Other platforms don't have this level of third-party customization.

"Really, the goal within Shopify is that you never have to replatform," says Jones. Having a legacy platform — or wanting to add an outside system — shouldn't be a reason not to use Shopify. Indeed, one of the only reasons to leave Shopify should be if you decide to shut down your business. As

### 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.
- The company is improving its competitive position as it adds new capabilities, third-party apps, and scale.

### KEY DATA

- **Headquarters:** Ottawa, Ontario
- **Website:** [www.shopify.ca](#)
- **Sign of a Breaker:** Top Dog
- **Market Cap:** \$2,181
- **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:** \$27.15

### 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, Workday, Zendesk

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Jones notes, customers tend to either leave early or — more likely — stay for the long haul. "As you start to sell," he said, "your chances of churning disappear."

### Keeping the Edge

It's interesting to note on Google Trends that ["Shopify" has overtaken "e-commerce"](#) in popularity as a search term (and it's closing in on ["ecommerce" without the hyphen](#)). While it would be a huge overstatement to say that the terms have become synonymous, this does indicate that people are thinking of Shopify specifically rather than e-commerce generally.

And that gets to a broader point about competition. The software industry has inherently low barriers to entry, so competition will always be an issue. But Shopify has come to dominate its smaller rivals. Just search for terms like "Shopify vs. Volusion" (not to mention platforms like Wix, Weebly, or WooCommerce) and you'll see any number of independent reviews detailing how Shopify has left its ostensible peers in the dust. Indeed, as Pacific Crest noted, Shopify's competition "seems to have stagnated" while Shopify continues adding new customers, the vast majority of which stick with the platform.

What's more, Shopify is increasingly reaching beyond its base of small-to-medium-sized businesses (SMBs) and taking market share from platforms aimed at larger customers, like Bigcommerce and the Magento unit of **eBay** ([NASDAQ: EBAY](#)). In fact, eBay has already shuttered Magento Go, which specifically targeted SMBs, partly in the face of competition from Shopify. Bigcommerce had 95,000 merchants when it last revealed numbers in mid-2015, versus 243,000 at last count for Shopify.

Shopify is following a classic disruption pattern, starting small and growing to accommodate larger customers. Making the leap to bigger enterprises that require sophisticated tracking of back-office functions, finances, and so on would eventually pit Shopify against software vendors like **Demandware** ([NYSE: DWRE](#)) and even fellow Rule Breaker **NetSuite** ([NYSE: N](#)), a potential conflict point. It's even possible that one of these companies could aim squarely at SMBs and challenge Shopify. But that is unlikely, and for now, Shopify can grow in relative peace. Even with healthy competition, it shouldn't have a problem finding more customers among the approximately 10 million SMBs it's targeting (not counting very small entrepreneurial startups or the larger businesses served by Shopify Plus).

### Full Carts Can't Lose

Meanwhile, Shopify's edge in direct sales through social media may be bearing fruit: More than 25% of Shopify merchants have enabled social-media selling on platforms like **Facebook** ([NASDAQ: FB](#)), **Twitter** ([NYSE: TWTR](#)), and Pinterest, according to *Investor's Business Daily*. Even without much in the way of direct sales through social media, Shopify has basically doubled revenue every year since it started reporting figures (it was up 95.4% in 2015 to \$205.2 million). Shopify's virtually frictionless tools for selling across unique channels should let the company continue to win market share.

The fast growth of the Merchant Solutions business — Shopify Payments in particular — will continue to put some pressure on gross margins this year, since it involves additional costs on Shopify's end, while incremental subscribers are virtually free. But since merchants who use Shopify are already subscribers, there is very little customer acquisition cost. Thus, the company's trend of improving its operating efficiency should continue. That means the operating margin should eventually improve as the company gains scale.

### Risks and When We'd Sell

The risk profile for Shopify hasn't really changed since last month. While we feel confident about the company's competitive position, the mere fact that this is such an attractive opportunity will continue to attract competitors. And Shopify's stock, despite remaining well off its highs, is still valued for strong growth.

We're looking for the company to grow its customer base 30% or more this year. We're also looking at the company's margins. While gross margin may come down as the mix of transactions going through Shopify Payments increases, we're looking for the company to end the year with its operating margin on the rise.

### The Foolish Bottom Line

Shopify will remain closely associated with SMBs for the foreseeable future, but this is a company really fixed on serving everyone from the lunch-break entrepreneur to the large enterprise — and especially on joining its customers on the path from one end of the spectrum to the other. If you shop at **Tesla Motors** ([NASDAQ: TSLA](#)) or even buy a Budweiser Red Light from **Anheuser-Busch InBev** ([NYSE: BUD](#)) (a must for [all you hockey fans](#)), you're shopping through Shopify. That name's not yet quite synonymous with e-commerce, but we think it will get there.

#### Talk About SHOP

Dollar amounts are in millions (except recent price)

Data as of March 17, 2016

#### RISK RATING AND 5 AND 3

We first recommended this company last month, so our usual supplemental information is unchanged. Click to read our [Risk Rating](#) and our [5 and 3](#).

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