Buy Shopify

Tom Gardner | April 20, 2018 | Buy Recommendation

CURRENT PRICE: SHOP $ 918.32 ↑ $ 13.51 (1.5%)

We've had plenty of time to study **Shopify** (NYSE: SHOP) since we first recommended it to you in July 2016, and if anything, we're even more excited today as we recommend it again.

Over the past two years, Shopify has cemented its status as the e-commerce platform of choice for small entrepreneurs — and its power and adaptability are attracting bigger customers, too. Its client base and gross merchandise volume are both growing explosively, which we take as confirmation of its quality.

At the same time, Shopify is also drawing attention from skeptics. One highly publicized short attack last fall knocked the wind out of the stock for a few months. Shopify went on to hit new highs earlier this year — until it stumbled along with other big tech companies in recent weeks.

I bring that up not to scare you but to explain why I think we have a buying opportunity on our hands. Young, fast-moving companies like Shopify are prone to volatility, and many of our biggest winners have had to ride out big short-term pullbacks on their way to ever greater highs. When we tune out the noise and study Shopify as a value-creating business, it stands out as a great investment.

Even though Shopify has gained more than 280% for members who bought after our first nod, I think there's more to come even here with the stock around $127. If you haven't bought shares yet, now is a great time.

An A+ for E-Commerce

Shopify's e-commerce platform is designed to give online merchants an easy way to handle all facets of their business: managing inventory, fulfilling orders, processing payments, and communicating with current and prospective customers alike. It can be used not just on desktop and mobile devices, but also gaming consoles and even in person at a physical

WHAT IT DOES

Shopify's e-commerce platform allows merchants of all sizes to build a digital presence on the Internet, including storefronts and fulfillment, payment, and shipping services.

WHY YOU SHOULD BUY

- Shopify's addressable market continues to grow as e-commerce captures a larger share of overall shopping.
- Founder Tobias Lutke continues to lead Shopify as chairman and CEO, and he has retained a sizable 8% stake in the company.
- Volatility has brought the stock's price a little lower lately, but its fundamental long-term prospects remain promising.

BUYER'S GUIDE

- **Industry:** Internet Software and Services
- **Size:** Mid Cap
- **Region:** North America
- **Risk:** 8 out of 25

KEY DATA

- **Headquarters:** Ottawa, Ontario
- **Website:** Shopify investor relations
- **Market Cap:** $13.3 billion
- **Cash/Debt:** $943 million / $0
- **Revenue (TTM):** $260 million

store. Crucially, it can also plug into online marketplaces like **eBay** (NASDAQ: EBAY) and social-media sites like Instagram. As I mentioned above, flexibility is a strength.

Small and medium-sized businesses still make up the core of Shopify's clientele, and you can get set up and running for as little as $9 a month. But the company also offers a $2,000 Shopify Plus package for bigger businesses — like food giant **Nestle** (NASDAQOTH: NSRGY) and energy-drink maker Red Bull.

So far, so good — or maybe great. Shopify's client base rose from fewer than 400,000 merchants in 2016 to more than 600,000 in 2017. Gross merchandise volume soared 71% to $26.3 billion, and revenue climbed 73% to $673 million. Just as impressive, Shopify is beginning to turn all this growth into profit. The company pushed its bottom line into the black in 2017on an adjusted basis (that is, if you don't count stock-based compensation; by generally accepted accounting principles, the company did show a loss, albeit a smaller one than the year before).

- **Earnings (TTM):** ($114 million)
- **Revenue (2015/'16/'17):** $205 million / $389 million / $673 million
- **Earnings (2015/'16/'17):** ($19 million) / ($35 million) / ($40 million)
- **Recent Price:** $127

Awesome growth, right? Yet even now, Shopify's addressable market remains much larger than what it's currently serving. The company estimates that there are 46 million small and mid-sized business around the world, and it's only serving 1.3% of them. That leaves plenty of opportunity for Shopify to keep growing well into the future.

There's good reason to think it will do so. Shopify has boosted its employee count to almost 3,000, up by nearly half in just the past 12 months. That's enabled it to improve existing services and add capacity for key channel partners. DHL and **United Parcel Service** (NYSE: UPS) joined Shopify's shipping partner list, and international moves into non-English-speaking countries have helped the e-commerce platform become a truly global player.

What Took It Down (and What Brought It Back)

But as I said in my introduction, companies in super-growth mode are susceptible to volatility. Let's go back to last October. Shopify's stock fell about 20% in a week following a provocative report from short-selling specialist Citron Research that called Shopify "a completely illegal get-rich-quick scheme" and suggested that the Federal Trade Commission should investigate the company for a "dodgy" recruiting method. Shopify CEO Tobias Lutke responded in kind, saying in the company's quarterly conference call later that month that "we were targeted by a short-selling troll who made all sorts of preposterous claims."

At the time, we reaffirmed Shopify as a buy, saying that while we'd keep an eye on some of Citron's claims, we believed in the company as a long-term holding. We'd never have predicted that the stock would rebound 65% from its lows over the next five months. But as we see it, Shopify was revived by investors' recognition of its long-term potential. Witness the demand for Shopify's secondary offering of 4.8 million shares in February — the company brought in about $657 million in cash to improve its balance sheet and give it flexibility for future strategic moves.

As Lutke put it, Shopify's focus on helping small businesses thrive connects with an increase in entrepreneurial spirit within the global economy. Shopify offers the picks and shovels that entrepreneurs need to pursue the gold rush of online retail, and Lutke sees that as a need that Shopify can serve into the 22nd century (really — it's in a letter he wrote for the company's IPO).

Shopify had another steep drop in the past few weeks, but the reason for this one was less juicy. Shopify has made key partnerships with **Facebook** (NASDAQ: FB), **Amazon.com** (NASDAQ: AMZN), and other major marketplaces and social-media channels, a key benefit of which was making it less likely that those companies would seek in-house solutions of their own. However, after Facebook came under fire in the Cambridge Analytica data-release scandal, Citron was quick to suggest that new limits on the social media giant's ability to collect and share data would reduce the value of Facebook's collaboration with Shopify.

We'll see. For Shopify's part, it sees a bright future ahead. For 2018, the company anticipates revenue growth of around 44% to 47%, with adjusted operating income coming in close to breakeven levels. And Lutke still has his financial incentives aligned with shareholders, holding an 8% stake in the company that briefly made him a billionaire (on paper) at the stock's peak. He has 87% approval on Glassdoor, and the company's rating is a healthy 4.1.

Risks and What We're Watching

We can never say it enough — volatility is not the same as risk. To us, risk is the likelihood that you'll suffer a permanent loss of capital. So if you buy Shopify, understand that you'll probably need to ride out some more ups and downs over the course of your investment and avoid the temptation of selling when the stock is out of favor. We think it'll be worth it, but it's never fun when a highflier hits turbulence.

Despite its first-mover advantage, Shopify isn't invulnerable either to a fellow upstart finding a new and better way to connect merchants or to an established tech giant looking to break into the business. Also, high valuations and the threat of cyberattacks remain potential risks, just as we identified in our original recommendation.

The Foolish Bottom Line

Shopify has already rewarded those who followed our 2016 recommendation, but we see further promise for the stock in the years ahead. We're looking forward to seeing how Shopify continues to expand into new market niches in its quest to make the e-commerce dream a reality for a growing number of businesses around the world.

Dan Caplinger contributed to this report.

Choose What You Want to Do With This Stock

By adding SHOP to your Favorites, you will be notified whenever our team recommends buying *or selling* SHOP.

John Mackey, CEO of Whole Foods Market, an Amazon subsidiary, is a member of The Motley Fool's board of directors. David Gardner owns shares of Amazon and Facebook. Tom Gardner owns shares of Facebook and Shopify. The Motley Fool owns shares of Amazon, eBay, Facebook, and Shopify. The Motley Fool has a disclosure policy.

Important Reminder! Access all of David Gardner's top stock recommendations

|
| | |