



Rating
Buy

North America
United States

TMT
Software

Company
Shopify

Reuters
SHOP.N

Bloomberg
SHOP US

Exchange
NYS

Ticker
SHOP

Date
5 December 2023

Forecast Change

Price at 5 Dec 2023 (USD)	74.72
Price target	85.00
52-week range	74.72 - 32.64

Product-centric culture to drive sustainable, profitable growth

We come away from Shopify's investor day better appreciating how the company's product-centric culture should lead to sustainable market leadership, revenue growth, and profitability. While the event itself was light on tangible details around attach rate and profitability over the medium term (two of the larger points of debate), we believe investors are pleased to learn how Shopify is leveraging its product-centric ethos internally, uniquely positioning the company to not only execute against its mission, but to do so at a rapid pace with improving employee productivity. Examples were shared of how the company differs from peers by focusing on builders (vs. managers) and leveraging internally built software to drive better outcomes for merchants. Additionally, further insight into upcoming product updates and GTM enhancements should provide longer-range comfort around growth initiatives, particularly enterprise and point-of-sale, to capture the company's stated TAM.

While medium-term attach rate and profitability still remain open to interpretation and subject to investor assumptions, we still come away feeling better near term on (1) monetization opportunities, and (2) operating margin expansion. Monetization was noted several times during the day suggesting pricing opportunities exist for Shopify Plus and across various merchant solutions, with the latter more of an upside surprise vs. current buy-side thinking. From a margin perspective, given all the discussion around operational excellence and 'arming the employees', along with a tone that remains cautious around headcount growth, we would not be surprised to see more muted OpEx growth as the company scales. Given some positive near-term data points along with longer-term appreciation around the company's true differentiation, we reiterate our Buy rating and raise our TP to \$85 from \$75. Our updated TP is based on: (1) slight improvements to out-year operating margins in our DCF; and (2) updates for recent changes in interest rates. As for near-term catalysts, we highlight potential upside to F4Q estimates given strong BFCM results, continued enterprise logo announcements, and potential price increases across Shopify Plus or Merchant Solutions.

Product

Management believes Shopify's ability to continue to gain market share (both on a merchant and ecommerce basis) is driven by: (1) being the easiest solution to help start a digital-native business; (2) enabling selling across multiple channels including in-person, B2B, globally; (3) having a strong developer platform and

Valuation & Risks

Bhavin Shah, CFA
Research Analyst
+1-212-250-6775

Brad Zelnick
Research Analyst
+1-212-250-8563

Valerie Zhang, CFA
Research Associate
+1-212-250-9116

Nick Giovacchini
Research Associate
+1-212-250-9075

Key changes

TP	75.00 to 85.00	↑	13.3%
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Source: Deutsche Bank

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ecosystem; (4) having technical and design excellence; and (5) gaining leverage from scale. In 2024 the company is looking to focus on the following: (1) handle large and complex products (i.e., products with multiple variations); (2) Provide staging for enterprise customers to seamlessly migrate from testing to production; (3) Improve the experience for enterprise retail customers; (4) expand payments and shipping support internationally; and (5) adding more B2B functionality.

Our Take: The drivers of share gains to date are not a surprise as they align with our customer/agency conversations. We see the 2024 product initiatives as underscoring the focus on Enterprise, Point of Sale, International, and B2B with continued product improvements assisting in driving adoption across each of these categories. We highlight complex product SKU was previously noted as a key concern for some larger enterprises.

Operations/Culture

COO Kaz Nejatian provided insight into how the company's product centric DNA has led to a superior merchant and consumer experience since the company's founding. Interestingly, the company has also adopted that product-centric ethos internally by: (1) creating an org structure around crafters vs managers, and (2) building class-leading software internally for employees to become more productive and remain merchant obsessed. Compared with most software peers that would leverage off-the-shelf solutions, Shopify is instead developing key solutions internally (with callouts for project management, HR service desk, performance marketing, voice of the customer) which is leading to better outcomes and a faster pace of innovation across all divisions. Merchant growth, top of funnel, performance marketing spend across various channels all improved as a result of many of the underlying changes internally.

Our Take: Perspective on how the company is structured very differently vs many others provides us with greater confidence that the company's merchant centric focus can drive rapid innovation and sustainable growth all while limiting meaningful headcount growth.

Enterprise

Datapoints around enterprise success to date validate much of our optimism heading into this year with the company noting a 43:1 win/loss ratio in the mid-market, 26:1 with larger customers, and 38:1 in enterprise (though in fairness Shopify's smaller market share upmarket likely limits share loss opportunities). The ability to take share has been driven by improvements to the product (i.e., having the software in place to understand the voice of the customer), and go-to-market enhancements. From a GTM perspective, internal alignment by industry has improved customer interactions and touchpoints while marketing efforts and leveraging industry analysts (i.e., Gartner) has offered validation to this segment of the customer base. Finally, investments into the partner ecosystem are beginning to pay off with \$20bn of GMV pipeline (~9% of FY23E total GMV) sourced from partners.

Our Take: We come away even more confident in the enterprise opportunity for Shopify which should drive sustainable GMV growth for several years as Enterprise remains in focus from both a product and GTM perspective. Shopify's statistics around share gains are validated by recent Commerce Cloud results from Salesforce and we expect additional international and B2B enhancements will further close any remaining feature gap. Commentary suggests the company remains intensely



Software
 Shopify

focused on market share gains which could limit any meaningful Shopify Plus price increases (a good thing longer-term, in our view).

Offline/B2B

Point of sale related revenue (payments, subscription, hardware) is growing ~1.5x Shopify's other businesses and is expected to be around \$450mn in FY23 revenue. The company attributes growth to what they believe is the best product in the market along with the continued importance of omni-channel. The go-to-market strategy around offline has evolved with the company now having dedicated sellers (vs prior being part of the cross-sell team) and this has led to strong growth in net new merchants to Shopify (68% of 3Q offline sales from non-Shopify customers). From a B2B perspective, the product enhancements listed above are driving new logo wins including Carrier, a B2B company transacting ~\$4bn/year in GMV that signed with Shopify last week as a result of current product strength along with the belief in continued innovation from Shopify.

Our Take: We still believe B2B is very early days and will have a limited impact to the near term financial model (though we are impressed with recent wins). Point of Sale remains very strong with Investor Day providing further evidence that this will be a meaningful revenue driver longer term and should be considered a new merchant acquisition channel.

TAM

With the company now addressing opportunities in almost every geo and across every channel, it unveiled a \$849bn total addressable market broken down between various components (see Figure 1). With the company only addressing 1% of its TAM, there remains ample runway for growth.

Figure 1: Current Market Share

	Subscription Solutions	Payments	Offline-B2B	Merchant Services	Total
TAM	\$81bn	\$157bn	\$473bn	\$138bn	\$849bn
2023E Revenue	\$1.8bn	\$4.0bn	\$0.5bn	\$0.7bn	\$7.0bn
Current Market Share	2.3%	2.5%	0.1%	0.5%	0.8%

Source : Deutsche Bank and Company Data

GMV and Revenue Growth Drivers

CFO Jeff Hoffmeister detailed drivers of GMV growth over the medium term including: (1) product innovation driving merchant share gains; (2) product enhancements enabling merchants to be more successful; and (3) a reduction in commerce friction driving further success with international/B2B. From a revenue perspective, we received further insight into the breakdown of merchant solutions revenue with overall revenue broken down by ~25% subscription solutions, ~60% payments/transaction fees, ~10% scaled products (Capital, Shipping, Markets), and ~5% emerging products. From an attach rate perspective, further payments penetration, adoption of newer emerging solutions, and pricing opportunities will more than offset some headwinds from enterprise success (larger discounts) and international (lower density of products today). Importantly, Mr. Hoffmeister remains confident that the combination of subscription solutions, payments, scaled products, and emerging solutions will create durability of revenue growth while also bending the innovation curve to help accelerate merchant success and thus Shopify success.



Our take: While we received no specific details to help quantify attach rate progress over the next several years, commentary regarding monetization opportunities across Subscription Solutions (likely Shopify Plus) and Merchant Solutions (likely raising prices or renegotiation of partner agreements) provide comfort around near-term opportunities. To us, management commentary around Enterprise pricing opportunities likely indicates some experimenting is perhaps more imminent (next 12 months) though the magnitude is likely to be smaller as the company still wants to drive market share. Insight into scale/emerging non-payment merchant solutions was helpful though it remains difficult to underwrite what the adoption curve will look like especially as enterprise traction grows.

Gross Margins and Profitability

As expected, the company did not provide medium- to longer-term targets but instead gave some insights into puts and takes for gross and operating margins. Gross margins should be stable to slightly dilutive going forward as Shopify Payments growth will more than offset an increasing mix of accretive non-payments merchant solutions and stability of subscription solutions. From an operating expense perspective, Mr. Hoffmeister reiterated that the company will remain disciplined on headcount (though thoughtful on additions in key geos), and that the company, with this current operating expense base, can continue to grow revenue with an ongoing sub-linear revenue to expense relationship.

Our take: While much of the gross margin discussion was known, further reiteration around the ability to remain prudent from an operating expense basis will continue to feed the bull narrative on operating margin upside over the next several years. If the company can continue to scale with a flatter organization (vs peers) given its internal improvements noted above, this should drive further confidence in margin expansion opportunities.

Risks and valuation

We adjust our TP to \$85 from \$75, based on our DCF analysis. Our DCF is based on a WACC of 9.1% and a terminal risk free rate of 4%. We use a terminal growth rate of 3.5%, based on GDP growth. Risks include: (1) Slowdown in consumer spending; (2) Increased competition for ecommerce software; and (3) Limited improvement in take rates.



Appendix 1

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Company	Ticker	Recent price*	Disclosure
Shopify	SHOP.N	74.72 (USD) 05 Dec 2023	NA

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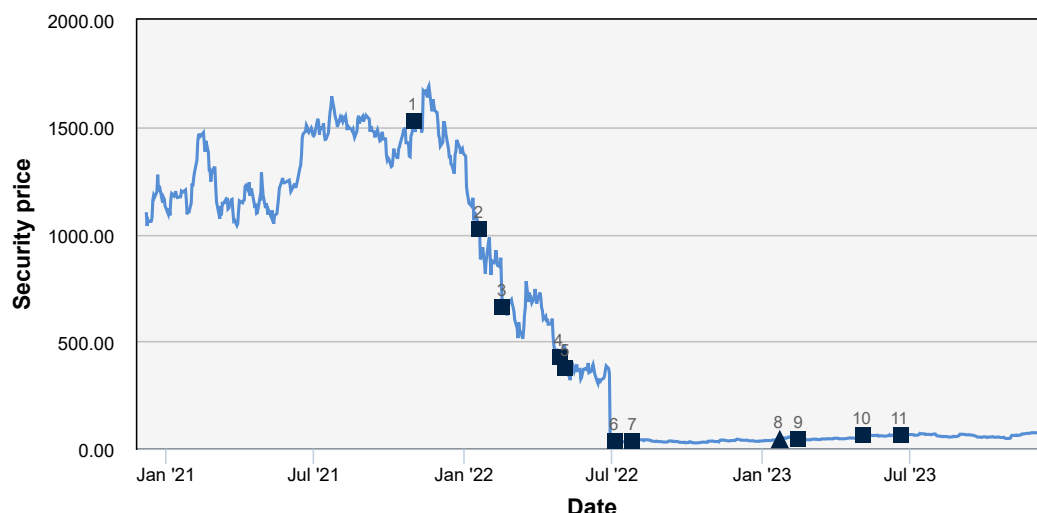
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Historical recommendations and target price: Shopify (SHOP.N)

(as of 12/05/2023)



Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

** Analyst is no longer at Deutsche Bank

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2.	01/20/2022	Hold, Target Price Change USD 1400.00, Current Price USD 1023.95 Bhavin Shah	8.	01/23/2023	Upgraded to Buy, Target Price Change USD 50.00, Current Price USD 44.04 Bhavin Shah
3.	02/17/2022	Hold, Target Price Change USD 900.00, Current Price USD 660.00 Bhavin Shah	9.	02/16/2023	Buy, Target Price Change USD 55.00, Current Price USD 44.91 Bhavin Shah
4.	04/29/2022	Hold, Target Price Change USD 550.00, Current Price USD 426.82 Bhavin Shah	10.	05/05/2023	Buy, Target Price Change USD 67.00, Current Price USD 62.03 Bhavin Shah
5.	05/06/2022	Hold, Target Price Change USD 500.00, Current Price USD 377.49 Bhavin Shah	11.	06/21/2023	Buy, Target Price Change USD 75.00, Current Price USD 63.17 Bhavin Shah
6.	07/06/2022	Hold, Target Price Change USD 50.00, Current Price USD 33.04 Bhavin Shah			

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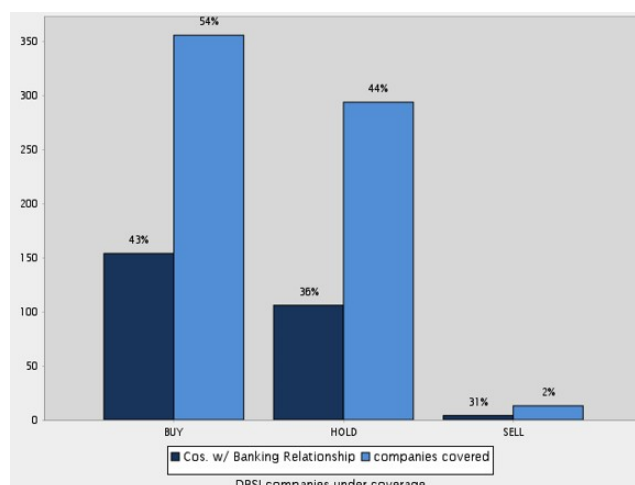
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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Pam Finelli
Global Chief Operating Officer
Research

Steve Pollard
Global Head of Company
Research and Sales

Jim Reid
Global Head of
Macro and Thematic Research

Tim Rokossa
Head of Germany
Research

Gerry Gallagher
Head of European
Company Research

Matthew Barnard
Head of Americas
Company Research

Peter Milliken
Head of APAC
Company Research

Debbie Jones
Global Head of
Company Research ESG

Sameer Goel
Global Head of EM & APAC
Research

Francis Yared
Global Head of Rates Research

George Saravelos
Global Head of FX Research

Peter Hooper
Vice-Chair of Research

International Production Locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Equity Research
Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6000

Deutsche Bank AG

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

The Deutsche Bank Center
1 Columbus Circle
New York, NY 10019
Tel: (1) 212 250 2500