# 3 Reasons Warren Buffett Will Not Be Buying Shopify Inc.

## Description

**Shopify Inc.** (TSX:SH)(NASDAQ:SHOP) is Canada's hottest stock right now, and for good reason. The Ottawa-based tech company, which helps small businesses sell their products online, has doubled its revenues in each of the past two years. And there's no end in sight for its rapid growth.

default watermark

But before you jump right in, you must understand this is a risky investment, the type that famed value investor Warren Buffett would never buy. Below we look at three reasons why.

**1. A big price, but no big profits**

As a value investor, Mr. Buffett places a big emphasis on earnings and cash flow. Growth isn't emphasized so much. If you don't believe me, just look at three of his largest holdings: **Coca-Cola**, **IBM**, and **American Express**. All of these companies are cash machines, yet none grew revenues by more than 3% last year.

Shopify cannot be described the same way. The company lost $22.3 million in 2014, and has an accumulated deficit of $29.1 million. This makes an investment much riskier, especially since Shopify trades for over 12 times revenue. By comparison, the three large companies above trade for less than three times revenue (on average), despite being far more profitable.

**2. Few barriers to entry**

Mr. Buffett is most interested in stocks that have a wide moat around their business. In other words, he looks for companies that can easily defend themselves against both current and future competitors.

The three companies above are once again perfect examples. Coca-Cola is protected by a ubiquitous brand, a secret formula, and powerful relationships. IBM is well-entrenched with large enterprises, and won't be dislodged easily. American Express is protected by the loyalty of its cardholders and a strong network effect.

Shopify's moat is a lot narrower. The company faces competition from companies large and small, and barriers to entry are not high in this industry. To give Shopify credit, it is the best at what it does. But the company must rapidly evolve to compete, and if competitors do a better job of this, then Shopify's growth numbers will suffer. That's a risk that Mr. Buffett simply isn't willing to take.

### 3. An aversion to IPOs

Mr. Buffett has been around for more than half a century, yet he can't recall buying a single IPO. Why? Well, IPOs come from very willing sellers, even when a bank intermediary takes a cut.

To understand this better, let's look at the Shopify IPO. Investors had to pay US$17 per share, but the investment banks took US$1.19 of that for themselves. So, Shopify and its founders were willing to sell equity for US$15.81 per share (and this number was even lower when the IPO process started).

Fast forward to today, and one Shopify share will cost you US$27, nearly double what the company very willingly sold its shares for. It's hard to imagine this being a bargain.

Granted, Mr. Buffett has missed out on some spectacularly successful IPOs, and this may be another one. But he is happy to avoid the risks, and that's something worth thinking about before you buy Shopify.

**CATEGORY**

1. Investing
2. Tech Stocks

default watermark

**TICKERS GLOBAL**

1. NYSE:SHOP (Shopify Inc.)

**Category**

1. Investing
2. Tech Stocks

**Date**
2025/07/21
**Date Created**
2015/06/02
**Author**
bensinclair

default watermark