Shopify Inc. Goes Shopping: Should You?

Description

It's been 10 days since **Shopify Inc.** (TSX:SH)(NYSE:SHOP) announced its acquisition of Kit CRM Inc., a San Francisco-based company whose virtual assistant app allows small businesses to better market their businesses. To say Shopify is stoked about acquiring Kit CRM is an understatement.

"We believe messaging apps are the gateway for the Internet on mobile, and conversational commerce represents a huge opportunity for Shopify," said Craig Miller, chief marketing officer at Shopify, in its press release on the deal. "Kit addresses a real pain point for merchants and is one of our most highly rated apps in the Shopify App Store."

Any time a growth company can make an acquisition that helps it become a better business, investors certainly have reason to be excited about its future prospects. Like draft picks in hockey, on paper, they always look good. But the reality is that very few acquisitions add value, and nowhere is that more true than in the high-stakes world of venture capital.

Shopify might have more than US$205 million in annual revenue and a market cap approaching US$3 billion, but it's yet to make a profit, losing US$17.8 million from operations in 2015 alone. Management will argue that this is all part of its scalability, and they wouldn't be wrong.

That said, my job isn't to sugarcoat the truth. At the end of the day, there are a lot of places investors can put their money—places that carry much less risk.

Fool contributor Jacob Donnelly recently took a look at Shopify stock and came away liking what he saw, suggesting its $40 share price is reasonable given its growth prospects. That very well might be, but winning when it comes to investing is all about preserving capital; the likelihood of Shopify disappearing into the ether is far greater than if you were to go with a proven commodity such as **Amazon.com, Inc.** (NASDAQ:AMZN), which is also still growing.

Why pay almost 16 times revenue for Shopify when you can get Amazon for less than three times sales and the genius that is Jeff Bezos?

You can argue all you want that Amazon closing its Webstores small business e-commerce software platform last September and recommending Shopify's software tools instead is a serious vote of confidence for it, but I just don't see Amazon abandoning anything unless it feels there's not enough money in it.

In other words, it's a hollow victory. But don't take my word for it.

Abe Garver is the managing director of Florida-based BG Strategic Advisors and an expert in the e-commerce industry. Last November he wrote on his blog, "Moving the e-Markets," a post about why Shopify stock might drop by 40% after beating Q3 analyst estimates.

For Garver, it all comes down to valuation.

In his mind, investors are drastically overpaying for Shopify's software-as-a-service (SaaS) revenue. Taking the median enterprise value-to-revenue multiple of 38 of public SaaS companies—6.8 times—and assuming 100% of Shopify's revenues are from SaaS, its enterprise value should be US$1.4 billion, and not its current valuation of $2.4 billion.

Of course, only about 60% of its business is the more profitable SaaS revenue with the remainder coming from its lower-margin Merchant Solutions business.

The e-commerce expert believes you shouldn't own Shopify stock until it's making money on an annualized basis; I couldn't agree more.

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