



The Shopify Inc. Business Model Makes it a Buy

Description

Warren Buffett is notorious for saying that it is far better to buy a wonderful company at a fair price than a fair company at a wonderful price. What helps make a company wonderful is its business model. In my opinion, the single greatest reason to buy **Shopify Inc.** (TSX:SH)([NYSE:SHOP](#)) is because of its incredibly strong business model.

Shopify is an e-commerce platform that allows merchants large and small to create new cloud-based websites in a matter of minutes. Before services like Shopify, it used to cost thousands of dollars to hire designers and developers to create custom e-commerce sites. Now it only costs a monthly fee.

And the pricing is incredibly fair. Businesses can opt for a \$29, \$79, or \$179 per-month plan unless they are very large, which would enable them to gain access to Shopify Plus. For a small business, only paying \$29 per month to get their store online is an incredibly reasonable price.

Because the price is monthly, Shopify is able to predict the sort of revenue it will have, allowing it to invest in further projects comfortably. This sort of software-as-a-service monthly recurring revenue (MRR) business model is a lucrative position to be in.

Shopify's other big business is its Merchant Solutions product line. Essentially, this handles all payment- and shipping-processing needs. This means that a customer can buy goods with their credit card and the merchant can get their postage right through Shopify. While this is low margin, the more goods sold, the more revenue for Shopify.

And finally, Shopify Capital gives cash advances to help businesses increase their inventory. Because Shopify also handles payment processing, it knows how much merchants can afford.

User growth went from 200,000 in the third quarter of 2015 to 275,000 in the first quarter of 2016. And according to a pitch deck on their website, more users are searching for Shopify rather than e-commerce. It's likely that only people looking to set up an e-commerce site are going to be doing those kinds of searches, so Shopify is dominating in finding new users.

And the numbers show it.

Its revenue grew by 112% from 2012 to 2013, by 109% from 2013 to 2014, and 95% from 2014 to 2015, ending at \$205 million. To get a little deeper, year-over-year revenue growth from Q1 2015 to Q1 2016 was 95% (\$37.3 million to \$72.7 million). The other big number to look at is the MRR, which was \$12.8 million in Q1 2016. This is an 85% CAGR from the \$1.1 million in revenue it saw in Q1 2012.

Finally, its gross profit has been on a tear, increasing 82% to \$39.3 million in Q1 2016 from \$21.6 million a year prior.

The other thing that I really like about this business model is that new customers don't immediately result in an increase in cost. Because of this, its operating leverage as a percentage of revenue has consistently dropped since 2012 from 84% to 58% in 2015. In 2016 it's up a little bit, but it's still drastically lower than it used to be.

There's no denying that Shopify still has a long way to go; however, I believe that because it is seeing growth MRR and reduced costs as a percentage of revenue, this stock has a lot of room to shine. Buying Shopify is a great idea.

CATEGORY

1. Investing
2. Tech Stocks

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