



## Shopify Inc.: The Pros and Cons

### Description

There aren't many TSX stocks that have performed better than **Shopify Inc.** (TSX:SH)([NYSE:SHOP](#)) in 2016; it's definitely on a roll, and its shareholders are the direct beneficiaries of its success. Those who've owned its shares since its May 2015 IPO have seen a 222% return in just 18 months.

Bravo to those who've held on to their stock.

Earlier this year I [cautioned](#) investors about owning Shopify stock while it was still losing money; I suggested that there were safer alternatives, such as **Amazon.com, Inc.** ([NASDAQ:AMZN](#)), to play the e-commerce gain.

Boy, was my timing off. Trading just about \$40 at the time, Shopify stock is up \$15, or 38%, since then compared to a 26% gain for Amazon.

So, I decided that now would be a good time to revisit Shopify's situation to assess the pros and cons of owning its stock and whether or not my views on owning its stock have changed. Here's what I found.

### Pros

Shopify's business model plays directly into the hands of retail's changing landscape. In the first half of 2016, online revenue in the U.S. grew by 11% year over year. Experts suggest online sales this holiday season will also grow by 11% to US\$91.6 billion. That's great news for a company whose e-commerce platform is used by more than 300,000 merchants.

Shopify announces its third-quarter results November 2. If they're anything like its Q2 results, Shopify's stock is likely to continue climbing higher.

In the second quarter, Shopify delivered a +90% revenue increase for the fourth consecutive quarter to US\$86.6 million with monthly recurring revenue—defined as the number of merchants in a given month multiplied by the average monthly subscription plan fee paid by merchants—up 70% to US\$14.4 million. Multiply that by 12, and you've got a pretty good idea what its subscription solutions business

will generate in 2016 (much more profitable than merchant solutions).

A number of large brands were added in the second quarter, including Boeing, Bose, and Hallmark. This kind of buy-in from major brands is critical to Shopify's long-term success, so that's a big win for sure.

Shopify Capital, the company's cash-advances program offered to its merchants, continues to gain traction with more than US\$5 million advanced as of June 30. Recently, it announced a partnership with Export Development Canada that will insure its cash advances, making the program safer for both the company and its merchants.

## Cons

Shopify is still not making money.

In the third quarter, Shopify expects an adjusted operating loss of at least US\$2 million on between US\$93 and US\$95 million in revenues. For the entire year, it expects an adjusted operating loss of at least US\$12 million on between US\$361 million and US\$367 million in revenue. On a GAAP basis, it expects an operating loss of at least US\$37 million—almost double the loss in 2015.

I still question the wisdom of buying Shopify at nine times revenue when you can own Amazon, a company with almost US\$9 billion in free cash flow, for three times sales. I just can't shake that.

In the second quarter, Shopify's subscription solutions segment grew by 72% while the much less profitable merchant solutions segment saw revenue grow by 121%. Shopify's subscription solutions segment makes 79 cents gross profit per dollar of revenue. Its merchant solutions segment makes just 27 cents gross profit from that same dollar of revenue. Ideally, you'd like to see those numbers reversed with subscriptions generating the bigger revenue growth of the two segments.

## Bottom line

Value investors will definitely not be buying Shopify stock. Growth investors can make the argument that Shopify is still very early in its growth story, and with almost US\$200 million in cash to cover its annual losses, which are naturally higher due to its increasing expenses, these growing pains are a part of the process.

There's a lot to like about Shopify. Ultimately, I do think it will make money. But at nine times sales, I can't recommend buying its stock. I just can't.

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. NYSE:SHOP (Shopify Inc.)
3. TSX:SHOP (Shopify Inc.)

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