



Shopify Inc.: Nowhere Near Reaching its Potential

Description

People have a hard time disconnecting value from price and only assume that because the price of something is high, the value must also be high. Naturally, this happens with stocks like **Shopify Inc.** ([TSX:SHOP](#))([NYSE:SHOP](#)). Over the past year, shares have gone from \$50 a share to nearly \$150 — a 160% increase. Therefore, it must be expensive, overpriced, etc., right?

Wrong.

In my opinion, Shopify is nowhere near reaching its potential. It only has 500,000 shops in its network across 175 countries. Shopify is focusing the bulk of its energy on core geographies that represent approximately 10 million potential customers with revenue potential of \$10 billion per year. However, once it expands to the global market, the goal is to target 46 million potential customers with annual revenue of \$57 billion.

Right now, though, you're acting more like a venture capitalist than a value investor when you buy Shopify, because you're investing for the company's future potential versus what it is currently achieving. So, let's look at how the company is doing and then explain why it supports a very strong future.

Shopify is broken into two pieces. The first is Subscription Solutions, which is its standard software-as-a-service business, where it charges customers anywhere from US\$29 to US\$299 per month to launch an online store. This is the predictable revenue that I've come to appreciate from Shopify and, in my opinion, this makes it a safer stock than other technology companies.

The other piece is the Merchant Solutions group, which generates revenue based on how successful its customers are. This includes services like payment processing, shipping label purchasing, and a multitude of other services. One that I am bullish on is Shopify Capital, which lends money to its customers for purchasing more inventory in exchange for repayment based on purchases on the platform.

Both of these pieces get you into the Shopify ecosystem, which then comes with distribution partnerships. **Amazon.com, Inc.**, which should be Shopify's competitor, actually views Shopify as an

ally. Shopify merchants can sell through Amazon, and Amazon gets a small cut. In the beginning of the summer, **eBay Inc.** signed a similar agreement, allowing Shopify merchants to sell goods through eBay as well.

In summary, here's the type of business you have ... It's relatively inexpensive and easy to launch a store on Shopify, making the barrier to entry very low for new customers. Once they're in, customers get the opportunity to sell their products on massive distribution sites, allowing them to increase revenue significantly. Along the way, Shopify earns a small cut every time a payment is processed or a label is purchased.

Revenue in the second quarter was US\$151.7 million, up 75% from the second quarter of 2016. Subscription Solutions revenue increased by 64% to US\$71.6 million, which is a sign that more merchants are joining the network. Merchant Solutions saw an 86% growth in revenue to US\$80.1 million, thanks to gross merchandise volume of US\$5.8 billion — up 74%.

As you can see, Shopify is executing really well. Is Shopify expensive? Yes. But if it continues to execute, investors will send this stock even higher because they believe the future is bright. Shopify is nowhere near reaching its potential, so you should join the company on its ride. I say buy.

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