



This 1 Thing Needs to Happen Before I'd Consider Buying Shopify Inc. (TSX:SHOP) Stock

Description

Shopify Inc. ([TSX:SHOP](#))([NYSE:SHOP](#)) stock got pummeled into a bear market thanks to the growth-to-value-rotation "[tech wreck](#)." The quarter was deemed by many as abysmal.

Although it appears that short sellers like Andrew Left of Citron Research are finally having their way, many respected analysts are claiming that Shopify is unfairly beaten up, and that investors have the stock utterly wrong after the release of Shopify's Q2 results, which were actually quite good.

It's a tug-of-war between bears and bulls right now, and while the stock looks appealing after the dip, one thing is stopping me from backing up the truck on shares.

What's the real quality of Shopify's subscriber base?

The real quality of Shopify's merchant base is a pretty big question mark to me, especially when you consider the potential for churn that'll likely be severely exacerbated come the next recession.

While Shopify Plus subscribers are of highest-quality merchants, it's arduous to quantify the majority of non-plus subscribers. As of the end of fiscal 2017, there were only 3,600 Shopify Plus merchants compared to 609,000 total merchants. In other words, Plus merchants accounted for 0.6% of total subscribers. Yikes!

While I'm a bull on Plus subscriber growth, more transparency needs to be shed on the remaining 99.4% of subscribers. I find it disturbing that the Shopify platform has, in fact, been used in the "drop shipping" of cheap (and/or counterfeit) goods into developed markets like Canada or the U.S.

Moreover, add Andrew Left's allegations of "get-rich-quick schemes" that use of the Shopify platform, and I think Shopify is a legitimate story whose real growth may be clouded by a niche group of individuals. Shopify isn't policing who uses its platform; it just collects subscription fees. That means drop shippers, shell companies, MLMs and other low-quality merchants could inflate growth numbers.

We live in an age where everybody wants to make a quick buck, and that's why a flood of pyramid

scheme-like MLMs and retail arbitrage entities have hit the market. They're not illegal, and it's not in Shopify's interest to discriminate against such low-quality merchants. However, it'd be a massive service for investors if Shopify would precisely identify and quantify its subscriber base, adding them into more specific tranches based on their quality and likeliness to stick around.

If that happened, short-seller theses would be crushed, and I believe there'd be a lesser degree of volatility on shares of Shopify.

Still an extremely cyclical stock

While I'm sure a huge chunk of Shopify's non-Plus subscribers are merchants with legitimate businesses, a great deal of them are still likely to falter come the next recession.

As Shopify's ecosystem continues to improve with various add-on features, I suspect plenty of small- or medium-sized businesses will immediately return as the economy re-enters contraction mode.

Thus, if you're a long-term investor, it may make sense to hold off and wait for the next anticipated economic downturn before backing up the truck on Shopify shares, especially since I think they'll lose a more substantial amount of their value relative to the broader market.

Foolish takeaway

While evidence of slowed growth in Q2 was a concern, Shopify did bring in some terrific enterprise customers in **SodaStream International Ltd.**, De Beers Group, and **Reckitt Benckiser Group**.

Moreover, with the potential to capitalize on the Canadian e-commerce marijuana boom, Shopify may soar, but until more we can get more specificity on the quality of Shopify's current merchant base, I'm hesitant to recommend the stock, no matter how cheap it gets.

Either wait for a potential (but unlikely) internal audit of merchants or for the "swamp to be drained" once the next recession arrives.

Given that [Badger Daylighting](#) went through a rigorous third-party auditing of its accounts to get short sellers off its back, it's not too far-fetched to think that Shopify may do the same. If it shows the public that short sellers are wrong, they'll be forced to back off, and the stock will prosper over the long term.

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