Microsoft Corporation (NYSE:MSFT) Is Ready to Take Down Shopify Inc (TSX:SHOP)

Description

Wall Street analysts can't seem to make up their minds about **Shopify** (TSX:SHOP)(NYSE:SHOP) stock.

Baird recently upped its price target, highlighting that Shopify continues to take market share. In a research note, one of Baird's analysts said that it would "take years and significant investment for others to catch up."

The same week, however, Citron Research issued a scathing report suggesting the stock could drop quickly. The report noted the ever-increasing number of competitors. Citron's official 12-month price target for Shopify stock is just $100, representing more than 50% downside.

What are investors to make of these conflicting viewpoints?

Notably, both analysts are correct. Shopify is indeed taking market share on a monthly basis, solidifying its leading position in the burgeoning digital retail sector. Meanwhile, competitive pressures continue to mount, throwing into question Shopify's ability to maintain its early lead.

A growing number of incredibly well-financed competitors have entered the market recently, including a tech behemoth that has the size to challenge nearly any company in the world: **Microsoft** (NYSE:MSFT).

This one will hurt

On April 3, Shopify stock dropped 3% in a single trading session after *The Information* revealed that Microsoft "is considering offering software tools that allow retailers to manage e-commerce sales." Microsoft's corporate vice president of retail and consumer goods said that the company is approaching the possibility "very seriously because our customers are asking us for it."

It's not surprising to see tech giants looking to capitalize on Shopify's good fortune. Last year, Shopify's sales exceeded $1 billion. In 2016, sales were less than $400 million. Microsoft only increased sales by 12.3% last year, so adding additional exposure to the rapidly growing e-commerce space could go a long way in delivering the consistent growth that shareholders expect.

In its short-seller report, Citron noted how expensive Shopify stock is versus other high-growth stocks, like **LYFT** (NASDAQ:LYFT). “Shopify operates in an increasingly competitive industry … while Lyft operates in a duopoly.” Still, Shopify shares trade at a relative premium.

Even worse, Shopify has a much smaller market to tap. **Royal Bank of Canada** estimates that Shopify’s total addressable market is between US$15 billion and US$20 billion. Lyft, meanwhile, will enjoy a US$285 billion market by 2030.

In ride sharing, the benefits of scale will continue to support a duopoly structure. At the minimum, a few large players will dominate the bulk of the space. E-commerce, however, doesn’t play by the same rules. As long as Microsoft can offer retailers a competitive product at a reasonable price, it won’t matter that Shopify currently has more customers.

It may take several years for Microsoft to fully catch up with Shopify, but pricing pressures could begin as early as this year.

Everything is priced in

Buying the stock of a company in a high-growth industry can be a recipe for success. If that stock is priced for perfection, however, conditions can change in an instant.

While Lyft shares trade at a lofty six times EV to sales, Shopify stock is valued at an astronomical 22 times EV to sales. Shopify will continue to grow, but a nose-bleed valuation combined with mounting competitive pressures could ultimately put a big dent in the share price.

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