The Key Thing About Shopify That Nobody Is Talking About

Description

Canadian technology unicorn **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP) has held up amazingly well through the recent global coronavirus pandemic. Investors appear ready to brush off short-term issues (like a recession!) and a potential slowing of medium-term growth.

Rather, they are seeing Shopify as a company with unstoppable, long-term growth potential via the global e-commerce shift/revolution.

One key factor

There is one key factor that investors need to consider right now. In fact, this factor has now become more pertinent than ever. Investors should consider the overall health of the average Small to Medium Enterprise (SME) globally, moving forward.

The core clientele of Shopify happened to be SMEs that are looking to shift to online sales to compliment traditional brick-and-mortar retail. Some SMEs are looking to replace traditional retail altogether. The question I don't think is being asked right now by investors is this: How will Shopify's SME churn rate evolve over time?

The bull argument

This impending recession, bulls will argue, will force many SMEs to invest in a Shopify e-commerce solution to keep the lights on. In addition, bulls will argue that, if anything, the recession will provide a boost to Shopify's growth in the quarters to come.

Shopify bulls will point out that this secular trend is incredibly strong. Therefore, bulls believe that nothing will stop the parabolic shift underpinning Shopify's fantastic rise to global dominance in the sphere.

The bear argument

But what about the impending recession? We haven't seen the likes of such a recession in approximately a century. I do agree that Shopify's business model is indeed supported by a very strong, long-term secular growth trend, which won't go away.

But I do question the fundamentals currently priced into Shopify as valuation. I don't see any real churn being factored into the company's stock price. At the very least, this risk is not being priced in to the extent that markets ought to be factoring it in.

This is particularly true given the number of bankruptcies on the horizon — impending bankruptcies as unfortunate as they are inevitable.

The hard truth

Companies that invest in a Shopify platform in a bid to stay alive today may simply not be around six months from now. The coronavirus pandemic is a major driver of retail business failure. (In fact, it is the trajectory of the coronavirus pandemic and its long-term impact that has driven me to change my mind about Shopify.

I worry that the quality of the average SME's underlying earnings is not being factored into Shopify's run rate. In addition, there is a real risk of meaningful, medium-term losses from an economic slowdown, which has the potential to bankrupt millions of SMEs globally (Shopify's target customer base).

Bottom line

This is a very difficult scenario for Shopify investors right now. One must weigh the long-term upside of Shopify with the near to medium-term volatility. The market appears to be completely brushing off this short to medium-term risk.

Since I simply can't understand the market's rationale for valuing Shopify's business, this is a company I simply can't invest in. I will remain on the sidelines.

Stay Foolish my friends.

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1. coronavirus
2. recession

3. Retail
4. Shopify

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