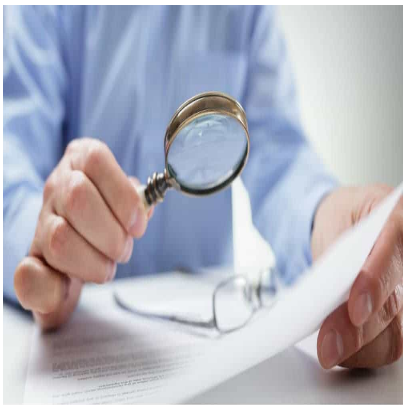

Wait: Look for These 2 Things Before Buying Shopify (TSX:SHOP)

Description

Shopify (TSX:SHOP)(NYSE:SHOP) has become the ultimate virus stock, growing 170% since the coronavirus outbreak. The COVID-19 pandemic created a perfect scenario for the e-commerce business, as people were locked at home, and many physical stores were closed. Shopify was well equipped to leverage this opportunity with an affordable, scalable platform that is easy to use. On top of that, it extended its free trial from 14 days to 90 days.

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Without a doubt, Shopify will design the future of e-commerce. It is a stock worth holding onto for the long term. However, investors rushed to buy the stock at higher premiums, making it an expensive share. The stock's rally was not backed by higher volumes, which means there are not many buyers and sellers of the shares. Its high price and low trading volume have made Shopify a risky stock. Hence, don't rush to buy the stock at its all-time high.

Shopify's business model

Shopify has a Software-as-a-Service (SaaS) business model. It hosts a cloud-based e-commerce platform that users can access with their login credentials on any mobile or laptop/PC with the internet. Retailers can create their online store for a subscription fee ranging from $29 to $299. For larger enterprises, the plan starts at $2,000. Premium plans offer advanced features like abandoned cart recovery.

Shopify also offers supporting solutions that retailers need to sell their goods. These solutions include Shopify payments, shipping, and Shopify Capital. The company charges a small percentage of the transaction amount as a commission. In all, the company earns revenue from subscriptions and merchant solutions. Both these revenue streams have their advantages and disadvantages. Hence, before buying Shopify stock, you should look at two things that will tell you whether the pandemic-driven growth is here to stay.

Shopify's monthly recurring revenue

Shopify’s primary source is subscriptions, from which it earns 40% of its revenue. The company spends a significant amount on sales and marketing to acquire new customers. This cost is justified if it can convert most of these new retailers into long-term subscribers, bringing a higher amount of recurring revenue. The Monthly Recurring Revenue (MRR) is a good indicator that shows Shopify’s conversion ratio. For the last three years, around 30% of the company’s subscription revenue was recurring. The MRR share will increase significantly if large enterprises subscribe to the Shopify platform, as they take premium subscriptions for a longer term.

During the pandemic, large brands like **Heinz** and **Loblaw** subscribed to Shopify. Even **Chipotle Mexican Grill** has subscribed to the Shopify platform for two years to help its suppliers’ open virtual farmers’ markets and sell products like meat and grains directly to consumers.

You should look at Shopify’s MRR for the second quarter. If there is a significant improvement in this percentage, the pandemic-driven traffic will generate longer-term revenue that will continue even when the pandemic situation normalizes.

Shopify’s gross merchandise volume

Shopify’s largest revenue stream is Merchant Solutions, which accounts for 60% of its revenue. This revenue increases when a higher number of transactions take place on the SaaS company’s platform. The Gross Merchandise Volume (GMV) tells the total amount of transactions executed on its platform. It has partnered with online marketplaces like **Walmart** and social media sites like **Facebook** to help merchants sell more goods, thereby increasing its GMV.

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Shopify is also looking to increase the percentage of commission from each transaction by offering additional services. During the pandemic, it added services like curbside pickup and fulfillment network. In the first quarter, it earned 1.6% of its GMV in Merchant Solutions’s revenue.

You should look at Shopify’s GMV for the second quarter. This figure is likely to double, as the company witnessed holiday season traffic during the lockdown. However, the surge in GMV could be a one-time thing and doesn’t necessarily reflect long-term revenue. Hence, it is essential to note the contribution of Merchant Solutions in Shopify’s overall revenue.

Investor output

Shopify’s partnership announcements and the U.S. online retail spending data indicate that the company will report one of its most robust quarterly earnings in August. Its second-quarter earnings will quantify the impact of the pandemic and give direction to investors’ expectations. Its stock could move 8-10% in either direction post-earnings. Wait till the earnings and then decided if you want to buy Shopify.

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