



## What Is Shopify's (TSX:SHOP) Growth Potential?

### Description

The recent market dips have significantly affected the stocks that surged the most in the market rally. The ultimate virus stock, **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)), dropped almost 20% in the recent selling, as investors cashed out the profits they made on its 180% rally it's had so far this year. The stock's market capitalization surged from \$55 billion on March 1 to \$136 billion on September 1, as investors priced in 10 years of growth.

Even though Shopify stock has declined to \$1,206, it is trading at 53 times its sales per share. Should you buy the stock at this valuation? To answer this question, you need to understand the value that Shopify stock can generate in the future.

## How do e-commerce companies make money?

Shopify adopts a Software-as-a-Service (SaaS) business model, which earns money from volume. As a SaaS company, its core source of income is subscription fees. Apart from that, it earns money from commission on every transaction.

It doesn't sell products to end consumers but helps merchants sell their products. Then how did it become a \$136 billion valuation company without having a product of its own except the Shopify platform? Even **Amazon** sells its products, like Alexa and Amazon fire stick, alongside the products of other merchants. The answer is volumes and economies of scale.

As an investor in Shopify, you should know that as more merchants, especially larger retailers, subscribe to the platform and stay, it earns more monthly recurring revenue (MRR). These merchants bring in traffic and transactions, which increases [gross merchandise volume](#) (GMV). Shopify charges a commission of around 1.5% on these transactions. This commission percentage increases as Shopify adds more premium features.

## How does Shopify grow?

Now that you know how Shopify earns money, how does it increase its income? This is where its flywheel comes into the picture. Its flywheel is similar to that of Amazon. The idea is to capture market share and become the world's largest online marketplace. Amazon went from being the world's biggest bookstore to becoming the world's biggest store that sells everything from A to Z.

Think of Shopify as a marketplace that attracts sellers. It gives sellers everything they need to sell their products efficiently. It gives them a store they can design the way they want and display their products, payment options, financing, marketing, and delivery. These sellers bring customers. As more customers come to the marketplace, more merchants open their stores to benefit from the traffic.

Where there are merchants and customers, more channels and partners like

This way, sellers can reach out to more customers and sell more, bringing more transactions. Now, channel partners earn the commission on transactions that happen through their channels. You will be surprised to know that Shopify's partners earn more revenue than Shopify.

## Shopify flywheel

Then how does Shopify benefit? It benefits from the movement of the flywheel. Even though Facebook and Walmart are earning transaction commissions, the volumes are attracting more sellers to the e-commerce platform, bringing more subscriptions. Subscription are its core business. Moreover, partners also recommend merchants open stores on the Shopify platform. As the platform grows, Shopify passes on the profit to merchants by adding capabilities that help them sell more.

Shopify prospers when its merchants and partners prosper. [In 2019](#), 44% more merchants achieved over \$1 million in GMV on the Shopify platform than the previous year. Here's a snapshot of the outcome of this flywheel:

- The number of merchants on the Shopify platform surged from 609,000 to 1.07 million between 2017 and 2019.
- Its GMV surged 134% from \$26 billion to \$61.6 billion
- Its MRR surged 80% from \$29.9 million to \$53.9 million.

The pandemic has just accelerated this growth. Hence, Shopify is a buy, even at its high valuation.

### CATEGORY

1. Coronavirus
2. Investing
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1. NYSE:SHOP (Shopify Inc.)
2. TSX:SHOP (Shopify Inc.)

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