Shopify: An Infinite Amount Of Land

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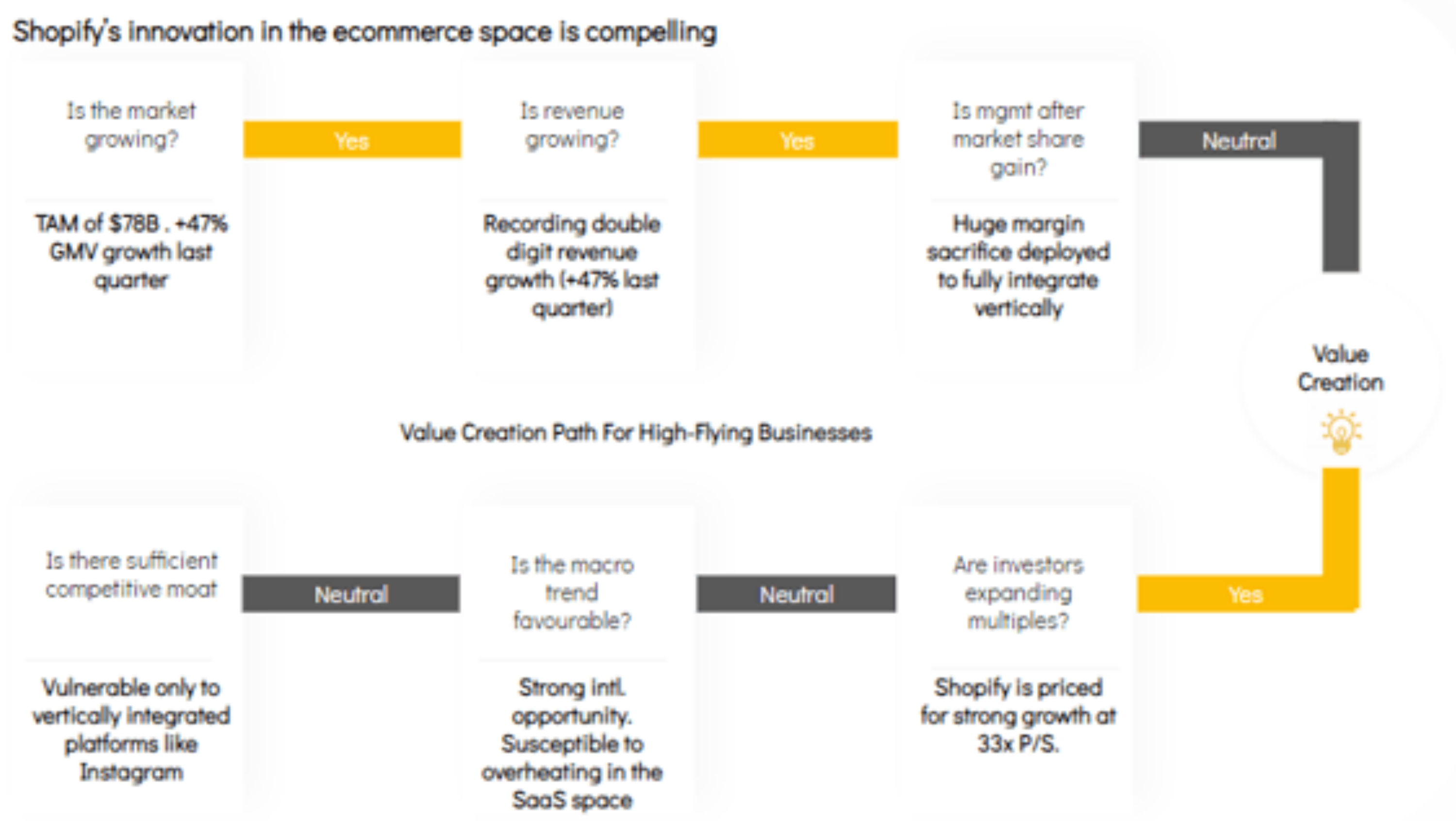
Summary

- Shopify is not your regular SaaS company.
- Shopify will continue to soar above its peers due to the huge economies of scale and competitive moat it has built over the years.
- I believe valuation is still attractive given that its future potential is easily underestimated.
- Investors should acquire some position as Shopify will continue to outpace other platforms catering to businesses who desire to own their distribution network.

Shopify's (SHOP) dominance as a SaaS platform will continue to expand until growth hacking platforms like Twitter (TWTR) and Facebook (FB) compete in the e-commerce space. The volume of data, economies of scale, and network effect gained over the years will continue to put Shopify above its peers. While valuation appears frothy, Shopify has a significant runway ahead of it as there is no limit to the success of businesses that can be built on the platform. Therefore, investing in Shopify can be likened to the execution of a call option that doesn't expire as the revenue it will potentially rake in by providing the leading vertically integrated platform for online businesses to set up stores will continue to drive sustainable free cash flow in the near term.



Source: Author

Shopify (SHOP) is an infinite piece of land for startups and SMEs to take a shot at creating a distribution network that will generate continuous cash flow if their product-market fit narrative is successful. This means entrepreneurs can spend more time on product-market fit to drive down their customer acquisition cost as great products mostly grow via word of mouth. Unlike Amazon (AMZN), brands don't have to worry about shelf space or competition once they've acquired a tribe of ardent followers or customers.

Though governmental agencies and Fortune 500 companies can use the platform, I see Shopify as a platform for small startups and mid-market e-commerce businesses, mostly targeting young entrepreneurs.

Shopify puts the decentralization in e-commerce without the need for all the blockchain hype. Like users pay a little transaction fee to use the bitcoin network, Shopify charges merchants a portion of every sale in addition to the initial provisioning cost for providing a robust e-commerce platform that is as vertically integrated as desired. This casts the net of its total addressable market really wide. A five-year-old who wants to create a toy review service while selling merch on the side after getting an invite on The Ellen Degeneres show can set up a Shopify site. Better put, Shopify is the Youtube of e-commerce. At the highest level of abstraction, Shopify's growth will closely correlate with global GDP growth. This correlation will be more pronounced in its top-performing regions, such as North America and Europe. This means consumer spending confidence and other indicators of economic growth will determine how ambitious entrepreneurs become and how much funding they attract to widen their distribution channels as they put their businesses online.

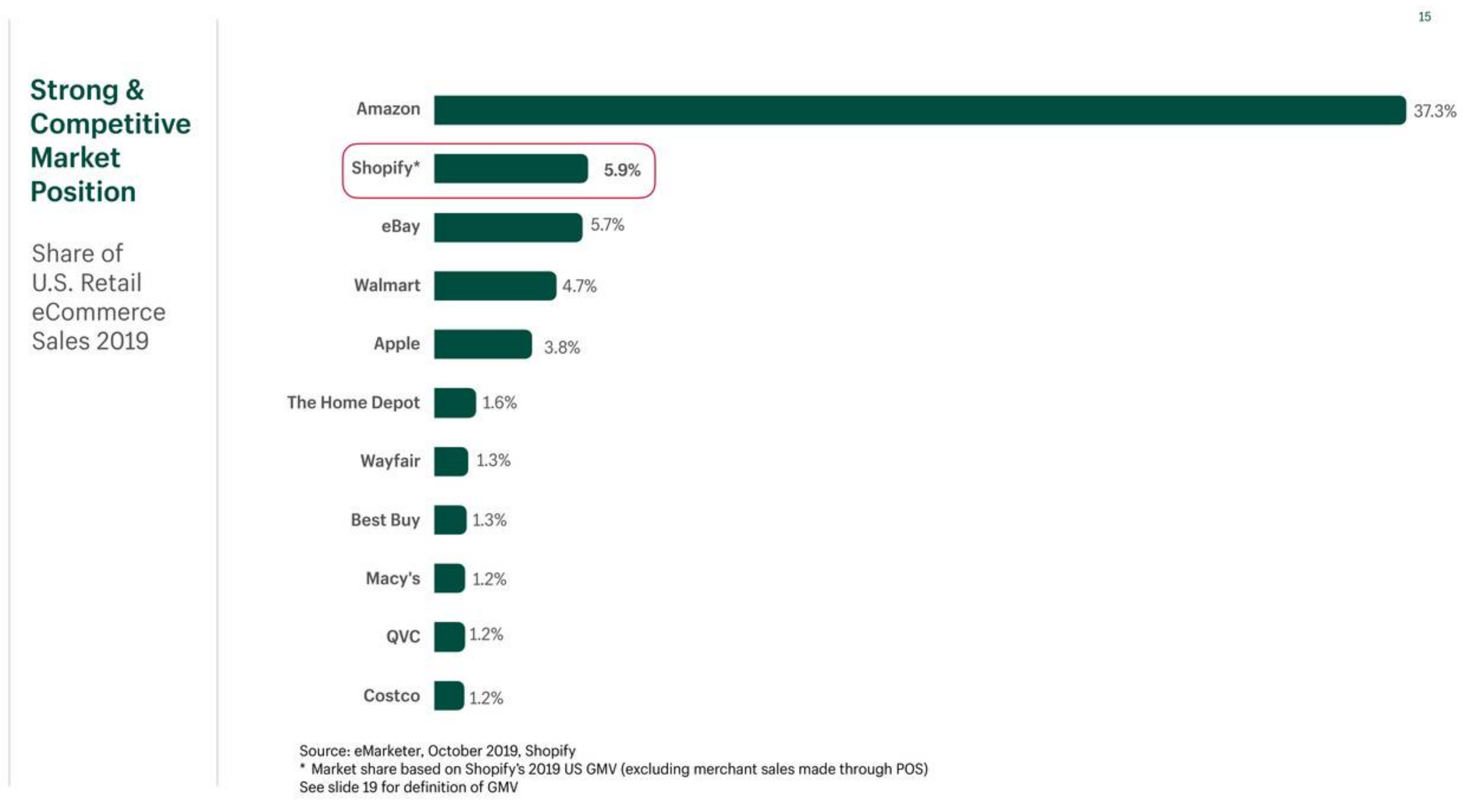
Source: Twitter

Like all things capitalism, not all Shopify sites will win. However, per industry, the death of poor executors will only serve to increase the market share of survivors.

The beauty of Shopify is that it prevents a distribution channel winner-takes-all. Instead, every Shopify site is a mini distribution channel whose growth depends on the total addressable market of the underlying business, marketing and sales budget, product pricing power, and product-market fit.

If bitcoin becomes a mainstream success, a lot of banks will lose payment processing fees and other hidden charges that have made them too big to fail. The same goes for Shopify. As Shopify grows, one less developer gets a fat contract to build an e-commerce platform from scratch. One less ad agency gets a contract, and one less payment gateway gets a contract. Though, I don't see Shopify as a competitor to developers, agencies, and e-commerce service providers. Leveraging Shopify, as a productivity tool, can also be a strategy for winning more customers. However, like all platform business models, they accrue the most value and IP to platform owners while partners and business architects fight for whatever is left.

Going forward, adoption will be less driven by vertical integration and fulfillment abstraction. Rather, maximum adoption will rely on growth hacking, virality, and brand building abstraction. While distribution will be the biggest challenge for Shopify's customers, we realize that the dream product already exists in Facebook's platform. I consider the Instagram/Facebook/WhatsApp trilogy to be the dream abstraction level. Instagram for brand building and virality, Facebook for pull marketing, and WhatsApp for customer service.



Source: Shopify

In terms of market opportunity, Shopify still has a massive runway ahead of it in terms of deal size and volume. There are tons of potential businesses that can be built off the platform, and it's hard to quantify how large and successful these businesses will become.

The biggest risk remains the growth hacking task that comes with owning 100% equity of a product distribution network. In seasons of economic prosperity, merchants will prosper. In seasons of economic gloominess, growth will be hampered, and this will impact Shopify's success. As with every unicorn e-commerce platform, Amazon's growth over the past twenty years has proven that there is an ample runway to be covered, and there is a wide margin of error susceptibility if we try to forecast Shopify's future growth.

However, investing in Shopify will have been a no brainer if platforms like Facebook and Google don't have growth hacking tools that could horizontally compete with Shopify.

Remember, Shopify is one of the multiple ways for retail businesses to reach out to potential customers. I see a possibility for Facebook to morph Instagram into a smart e-commerce-like solution with WhatsApp providing further leverage on the side as a marketing and brand-building tool. While both Shopify and Facebook can co-exist, the incentive for potential users who find both the capital requirement and abstraction level of Shopify a little challenging will swing the battle in Facebook's favor.

Shopify's strength lies in accessibility, fulfillment, and the maximization of the equity that accrues to owning a website as a distribution channel. The fact that Shopify has to add payment and financing facilities shows the limited network effect and growth hacking opportunities that can be derived from the platform. This is where Amazon, Google, and Facebook will thrive. Even Twitter becomes a competitor with overwhelming reach the moment it creates a shopping channel for brands on its platform.

It's not clear how and when the major competitor will emerge, however, for now, the market opportunity is large and baring the presence of any global macro headwind in the retail space, Shopify will continue to defy all valuation metrics due to the overwhelming volume of opportunity that can be built off the platform.

In the face of a rapidly growing industry disruptor, while having the network effect as a catalyst, most traditional investment theses fold, and most traditional valuation models and metrics, bow. The network effect has been a bet on market dominance via investments in intellectual and brand capital. Therefore, for now, Shopify's intangibles, stock-based compensation, and other market-measures of non-physical assets will appear inflated.

As Shopify continues to scale, customer acquisition costs will decline, and margins will improve off its strong base of growing recurring revenue. While valuation appears expensive at 33x P/S, betting against a fast-growth industry disruptor is ill-advised. My best bet is to acquire a little position and average down if there is a market correction. With the huge economies of scale about to be derived from its experience in the e-commerce space, it's hard to see competitors catching up with Shopify.

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