Short Ideas | Services | Canada

Fundamentals Demystified: Shopify, Valued 1.7x Higher Than Their Total Addressable Market

Jul. 27, 2020 9:30 AM ET | 11 comments | About: Shopify Inc. (SHOP)

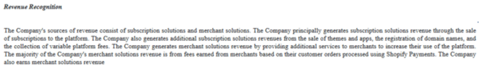
Oracle Of Alpha
Long/short equity, Growth, momentum, long-term horizon
Follow
(292 followers)

Summary

- Total addressable market for subscription solutions estimated at $4.78 billion FY20.
- Total addressable market for merchant solutions estimated at $65.20 billion FY20.
- Market capitalization of $118 billion, representing a price to sales ratio of 68x and 68.6% higher than TAM across both revenue segments.
- I maintain my price target of $118 with anything above $186 being completely uninvestable.

Company Overview (1)

Founded by German-born Canadian entrepreneur Tobias Lütke in 2004, Shopify (SHOP) is an e-commerce platform that enables merchants of nearly any size to quickly and easily setup an online store and begin selling their products. They generate revenue through two separate segments -- high margin subscription solutions and low margin merchant solutions. Both of these are described in deeper detail later in the article, but here is a brief overview of what each of these two segments are.



Revenue Recognition

The Company's sources of revenue consist of subscription solutions and merchant solutions. The Company principally generates subscription solutions revenue through the sale of subscriptions to the platform. The Company also generates additional subscription solutions revenues from the sale of themes and apps, the registration of domain names, and the collection of variable platform fees. The Company generates merchant solutions revenue by providing additional services to merchants to increase their use of the platform. The majority of the Company's merchant solutions revenue is from fees earned from merchants based on their customer orders processed using Shopify Payments. The Company also earns merchant solutions revenue

Source: SEC Filing

Subscription solutions is their recurring subscription component with revenue generated from variable platform fees, typically as a monthly subscription, theme and app store purchases, and domain registrations. This is their most profitable segment with a phenomenal 80% gross margin.

Merchant solutions is their success-based component with revenue generated principally through payment processing fees from Shopify Payments. In addition to Shopify Payments, revenue in this segment is also collected from transaction services, referral fees, Point-Of-Sale ("POS") hardware, Shopify Capital, Shopify Fulfillment Network, and collaborative warehouse fulfillment solutions. The collective revenue in this segment is directionally correlated with the level of Gross Merchandise Volume ("GMV") processed through the Shopify platform.

Article Overview (2)

It's likely no secret, given my previous two articles Shopify's Road To $200 and Shopify's Hyper Bubble Put In Perspective, that I'm not *super* bullish on the company. Granted, with a $118 billion market cap in conjunction with trailing revenue of $1.73 billion and a $135 million net loss, it's a bit difficult to argue otherwise. However, I have already gone over the valuation concerns to the point of exhaustion, and this article will focus entirely on fundamentals.

As noted in the previous section, Shopify's revenue is broken into two separate segments, and my goal is for every reader to have a solid fundamental understanding of both by the end. Here I will not only break down where the revenue comes from for each, along with a variety of other financial metrics, but also attempt to estimate the total addressable market for each along with some reasonable projections.

Ordered Sections

- 1 - Company Overview
- 2 - Article Overview
- 3 - Retail E-Commerce Market Overview
- 4 - Alexa's Link To GMV
- 5 - Understanding The Data
- 6 - Retail E-Commerce Market Breakdown
- 7 - Shopify's Earnings Highlights
- 8 - Shopify's Subscription Solutions
- 9 - Shopify's Merchant Solutions
- 10 - Conclusions

Retail E-Commerce Market Overview (3)

Due to the fact that the overwhelming majority of Shopify's revenue comes from its online stores, whether directly through subscription solutions or relative to sales through merchant solutions, a great starting point would be to determine just how large this market is. Using data compiled by BuiltWith we can not only determine its total size but more specifically narrowed by cohort.

Their market control among the top ranked cohorts is significantly more

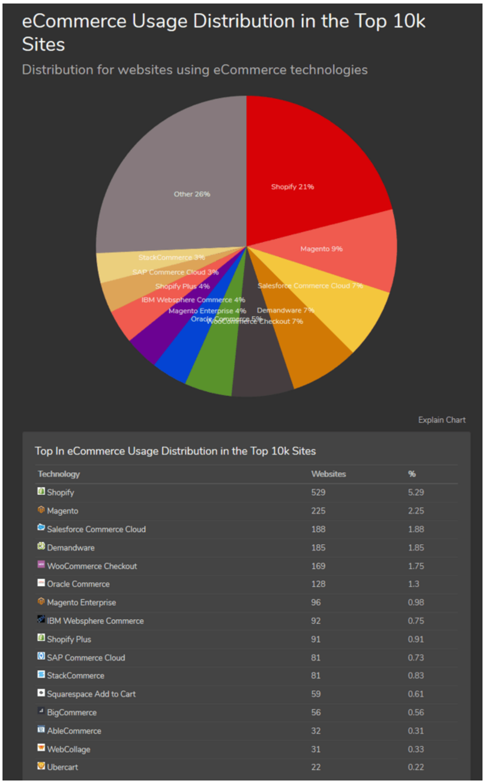
Depot
Add symbol Edit

VRNT	44.04	2.32%
SHOP	947.48	1.90%
AAPL	377.41	1.88%
GOOGL	1,530.74	1.49%
NVO	67.28	1.69%
AMZN	3,047.47	1.28%
FB	232.73	0.88%
GILD	74.30	0.89%
ACN	222.94	0.68%
CHD	86.45	0.68%
BABA	249.59	0.24%
DG	191.06	-0.33%
CHTR	558.29	-0.61%

Expand Portfolio

beneficial to merchant solutions, while their global market share is significantly more beneficial to subscription solutions. The reason for this is a confirmed connection between a websites Alexa rank and its sales, which will be explained in further detail later in the article.

As a final reminder, subscription solutions are linearly correlated with the quantity of stores on the Shopify ecosystem while merchant solutions are directionally correlated with the GMV of those stores, specifically any GMV processed directly through Shopify.



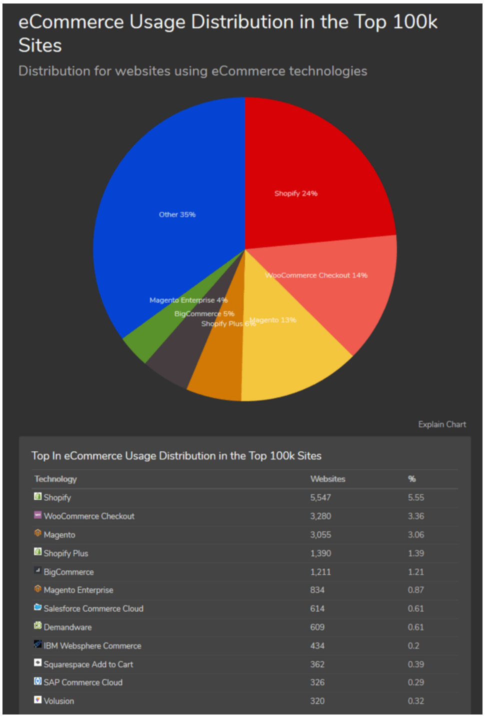
eCommerce Usage Distribution in the Top 10k Sites

Distribution for websites using eCommerce technologies

Top In eCommerce Usage Distribution in the Top 10k Sites

Technology	Websites	%
Shopify	529	5.29
Magento	225	2.25
Salesforce Commerce Cloud	188	1.88
Demandware	185	1.85
WooCommerce Checkout	169	1.75
Oracle Commerce	128	1.3
Magento Enterprise	96	0.98
IBM Websphere Commerce	92	0.75
Shopify Plus	91	0.91
SAP Commerce Cloud	81	0.73
StackCommerce	81	0.83
Squarespace Add to Cart	59	0.61
BigCommerce	56	0.56
AbleCommerce	32	0.31
WebCollage	31	0.33
Ubercart	22	0.22

Source: BuiltWith [Top 10k]



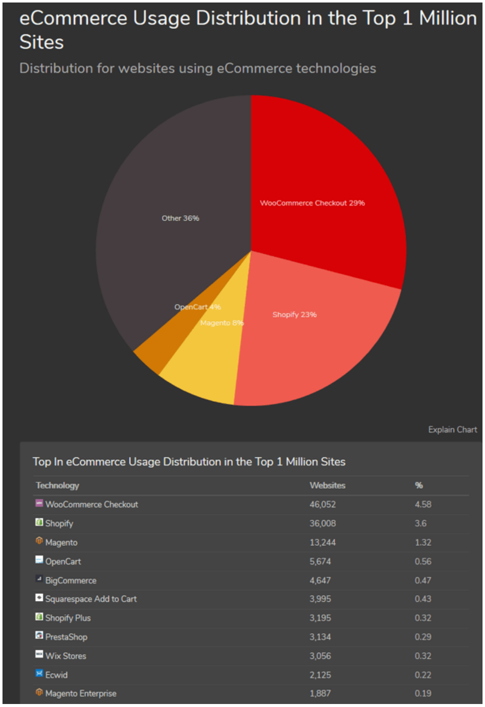
eCommerce Usage Distribution in the Top 100k Sites

Distribution for websites using eCommerce technologies

Top In eCommerce Usage Distribution in the Top 100k Sites

Technology	Websites	%
Shopify	5,547	5.55
WooCommerce Checkout	3,280	3.36
Magento	3,055	3.06
Shopify Plus	1,390	1.39
BigCommerce	1,211	1.21
Magento Enterprise	834	0.87
Salesforce Commerce Cloud	614	0.61
Demandware	609	0.61
IBM Websphere Commerce	434	0.2
Squarespace Add to Cart	362	0.39
SAP Commerce Cloud	326	0.29
Volusion	320	0.32

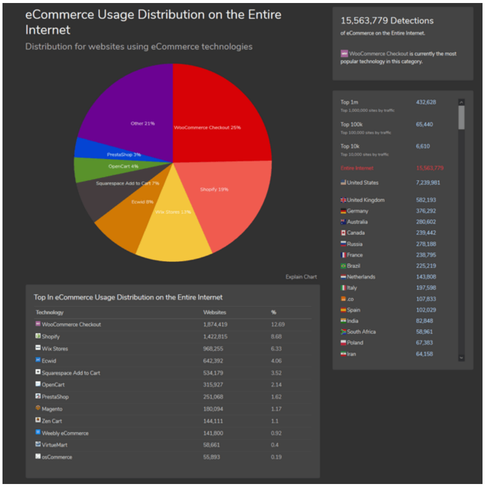
Source: BuiltWith [Top 100k]


eCommerce Usage Distribution in the Top 1 Million Sites
Distribution for websites using eCommerce technologies
WooCommerce Checkout 29%
Other 36%
OpenCart 4%
Magento 8%
Shopify 23%
Explain Chart

Top In eCommerce Usage Distribution in the Top 1 Million Sites

Technology	Websites	%
WooCommerce Checkout	46,052	4.58
Shopify	36,008	3.6
Magento	13,244	1.32
OpenCart	5,674	0.56
BigCommerce	4,647	0.47
Squarespace Add to Cart	3,995	0.43
Shopify Plus	3,195	0.32
PrestaShop	3,134	0.29
Wix Stores	3,056	0.32
Ecwid	2,125	0.22
Magento Enterprise	1,887	0.19

Source: BuiltWith [Top Million]


eCommerce Usage Distribution on the Entire Internet
Distribution for websites using eCommerce technologies
Other 21%
WooCommerce Checkout 25%
PrestaShop 3%
OpenCart 4%
Squarespace Add to Cart 7%
Ecwid 8%
Wix Stores 13%
Shopify 19%
Explain Chart

15,563,779 Detections

of eCommerce on the Entire Internet.

WooCommerce Checkout is currently the most popular technology in this category.

Top 1m Top 1,000,000 sites by traffic	432,628
Top 100k Top 100,000 sites by traffic	65,440
Top 10k Top 10,000 sites by traffic	6,610
Entire Internet	15,563,779
United States	7,239,981
United Kingdom	582,193
Germany	376,292
Australia	280,602
Canada	239,442
Russia	278,188
France	238,795
Brazil	225,219
Netherlands	143,808
Italy	197,598
.co	107,833
Spain	102,029
India	82,848
South Africa	58,961
Poland	67,383
Iran	64,158

Top In eCommerce Usage Distribution on the Entire Internet

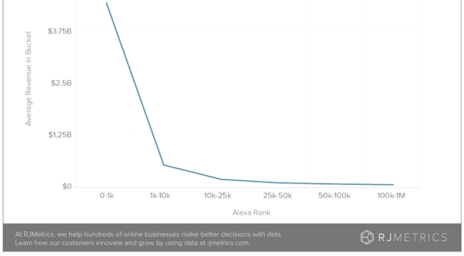
Technology	Websites	%
WooCommerce Checkout	1,874,419	12.69
Shopify	1,422,815	8.68
Wix Stores	968,255	6.33
Ecwid	642,392	4.06
Squarespace Add to Cart	534,179	3.52
OpenCart	315,927	2.14
PrestaShop	251,068	1.62
Magento	180,094	1.17
Zen Cart	144,111	1.1
Weebly eCommerce	141,800	0.92
VirtueMart	58,661	0.4
osCommerce	55,893	0.19

Source: BuiltWith [Entire Internet]

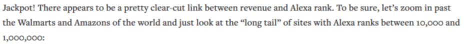
Alexa's Link To GMV (4)

There's a fantastic article by Robert J. Moore that tries to answer an important question -- How Many E-Commerce Companies Are There? Unfortunately the article is about six years old, completely ancient by tech standards, but it's still incredibly relevant in many respects and takes advantage of proprietary data to give us a unique look into the relationship between Alexa Rank and GMV. For example he uses anonymized statistics taken directly from many of these stores in conjunction with Alexa to generate a rough translation between site ranking and revenue generated while confirming the results. Here are two of the charts generated from said analysis, along with its conclusions.

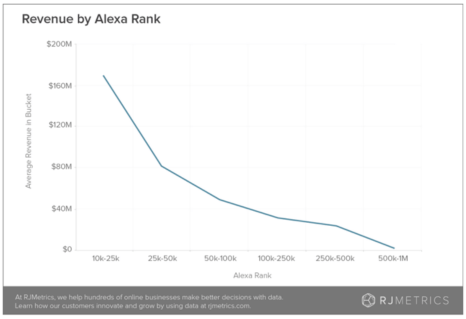
> To get revenue data, we turned to the data in the Internet Retailer Top 500 guide and augmented it with our own proprietary benchmarking data set. The IR 500 includes the heaviest-hitters in ecommerce and our own data covered mid- and smaller-sized companies. Between these two data sets we had Alexa rank and revenue data on the full spectrum of ecommerce companies. Here's what we saw:



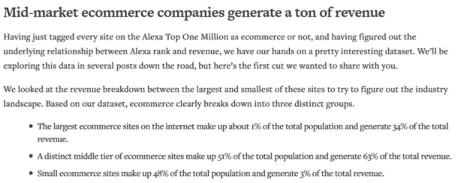
Source: RJmetrics



Jackpot! There appears to be a pretty clear-cut link between revenue and Alexa rank. To be sure, let's zoom in past the Walmarts and Amazons of the world and just look at the "long tail" of sites with Alexa ranks between 10,000 and 1,000,000:



Source: RJMetrics



Mid-market ecommerce companies generate a ton of revenue

Having just tagged every site on the Alexa Top One Million as ecommerce or not, and having figured out the underlying relationship between Alexa rank and revenue, we have our hands on a pretty interesting dataset. We'll be exploring this data in several posts down the road, but here's the first cut we wanted to share with you.

We looked at the revenue breakdown between the largest and smallest of these sites to try to figure out the industry landscape. Based on our dataset, ecommerce clearly breaks down into three distinct groups.

- The largest ecommerce sites on the internet make up about 1% of the total population and generate 34% of the total revenue.
- A distinct middle tier of ecommerce sites make up 51% of the total population and generate 63% of the total revenue.
- Small ecommerce sites make up 48% of the total population and generate 3% of the total revenue.

Source: RJMetrics

This shows that using the top million websites is a fantastic metric to predict a companies revenue given its correlation with Alexa ranking. Moreover it's clear that the vast majority of meaningful sales is going to come from this cohort. While there are certainly a number of businesses generating six figures outside of this range, you can see how rapid the exponential decrease is and anything further out is extremely unlikely to be generating anything meaningful, with the top 10k e-commerce websites making up roughly 34% of total revenue. What does this mean for Shopify in particular? This is where their merchant solutions shine given it's a direct reflection of how successful the businesses on their platform are, the better Shopify does in the top million (and above) the greater their merchant solutions revenue will be.

Understanding The Data (5)

When looking at the previously shown market distribution images, shown in section three, you'll likely notice there are two separate usage distributions given; one in the pie chart and another listed below that. While BuiltWith does explain where these numbers come from, it unfortunately appears to be outdated as the numbers don't match up as they describe. However, while waiting on an official response, I ended up just working out how the numbers are determined myself.

Determining Total Sites & Detections

	s1.Pi.com	s2.Pi.com	s1.Rho.com	s2.Rho.com	Gamma.com
Site Domain	Pi	Pi	Rho	Rho	Gamma
Total Sites	1	1	2	2	3
Total Detections	1	2	3	4	5
Total Sites	1	1	2	2	3

- **Sites** can be measured as the number of separate parent domains the platform has been detected on. This is an important distinction because more than one platform can be detected on a single site and, perhaps more importantly, all subdomains of a given parent domain are considered to be one site.
- **Detections** can be measured as the number of unique stores found across the entire cohort, including subdomains. As opposed to *sites* being limited to the parent domain, *detections* extend to the fully qualified domain.
- **Summary** is that each unique URL can have any number of platforms detected on it, but no more than one of each. To qualify as a new site it must have a unique parent domain. For example 500 subdomains, each with its own unique store, but all sharing the same parent domain, will contribute *+500 to detections* but never more than *+1 to sites*.
- **Shopify** has an important quirk to keep in mind in that every single free trial is given their own subdomain on MyShopify. Simply put, every trial store will be considered one additional Shopify detection without changing the total number of sites due to each one sharing the same parent domain. This will be used for further analysis later.

Determining Market Share

	Pie Chart Ratio	Listed Ratio
Numerator	Platform Total Sites	Platform Total Sites
Denominator	Cohort Total Sites	Cohort Size

Alternate Name	Market Share	Cohort Share

- **Market share** is generally the most important metric as it tells us precisely what the market share is specifically among all unique parent domains. The ratio is calculated based on unique store sites relative to the total sites within the given category.
- **Cohort share** is not very useful in and of itself, but in conjunction with market share we can use this to determine exactly how many "duplicate sites" each platform has. This is the ratio of platform detections relative to the total size of the cohort. For every "Top N" categories, "N" is the divisor (e.g top 10k has a 10k divisor) while on the "Entire Internet" category it uses total detections as a divisor

Retail E-Commerce Market Breakdown (6)

Given the previously described data, we can now build a table describing what the market looks like for any given cohort. Note that due to each subsequent cohort including all previous ones, we will be discarding total sites from all previous cohorts. For example, the top 100k category shows 5,547 Shopify sites detected but this includes the 529 from the top 10k cohort, so it should be 5,018. This will keep each cohort separately contained rather than building on top of one another, providing a much more accurate picture of each.

Everything shown below uses data from BuiltWith along with a lightweight program to separate each cohort into its own container, as described earlier. You can find both the data used and source code here for reference.

Top 10k	**Total**	**Shopify**	**Magento**	**Woo**	**Shopify+**
Rank		#1	#2	#5	#9
Sites	2,509	529	225	169	91
Market Share	100%	21.08%	8.97%	6.73%	3.63%

- This is by far the most important cohort for Shopify and they have a commanding 21.08% market share, even higher at 24.71% if you include Shopify Plus. Remember that merchant solutions thrives relative to GMV and the overwhelming majority of global e-commerce is in the top million, with the top 10k in particular contributing 34% of the total.

10k-100k	**Total**	**Shopify**	**Woo**	**Magento**	**Shopify+**
Rank		#1	#2	#3	#4
Sites	21,044	5,018	3,111	2,830	1,299
Market Share	100%	23.85%	14.78%	13.44%	6.17%

- You can see here that Shopify continues to command a strong market lead among its competitors in the second most important cohort for GMV. They have also doubled their market share for Shopify Plus over the previous cohort. Between the two Shopify controls 30% of all e-commerce websites within this cohort, more than double Woo in second place.
- As an interesting side note, BigCommerce isn't listed but it's right behind Shopify Plus at 1,211 market share in this cohort. They are also not far behind in the top 10k at 56 sites, for a combined total of 1,267 sites in the top 100k as compared to Shopify Plus at 1,390.

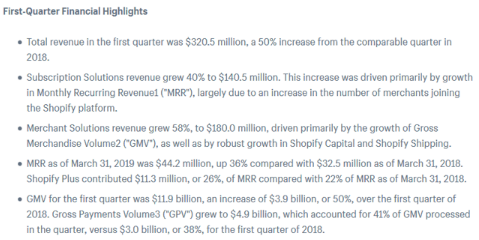
100k-1m	**Total**	**Woo**	**Shopify**	**Magento**	**ShopifyPlus**
Rank		#1	#2	#3	#4
Sites	134,724	42,772	30,461	10,189	1,805
Market Share	100%	31.17%	22.58%	7.42%	1.34%

- This is the final cohort with any meaningful sales, it's far more important to them to increase their share in this and previous cohorts than it would be to expand further outside of it. The reason is simply that the global market size for subscription solutions is only around $5 billion, which we will get into shortly.

1m+	**Total**	**Woo**	**Shopify**	**Wix**	**Ecwid**
Rank		#1	#2	#3	#4
Sites	7,425,540	1,828,367	1,386,807	968,255	642,392
Market Share	100%	24.62%	18.67%	13.04%	8.65%

- Here we have the final cohort, all websites outside of the top million. The vast majority of online stores reside here and nearly none of them generate meaningful revenue. This cohort is significantly more important for subscription solutions revenue than merchant solutions revenue, a single store in the top 10k can generate more GMV than a million different stores in this cohort.

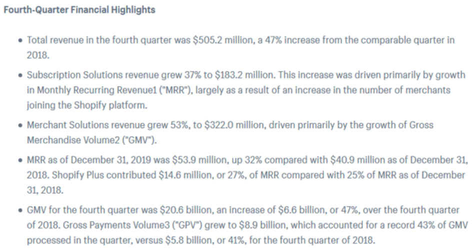
Shopify's Earnings Highlights (7)



First-Quarter Financial Highlights

- Total revenue in the first quarter was $320.5 million, a 50% increase from the comparable quarter in 2018.
- Subscription Solutions revenue grew 40% to $140.5 million. This increase was driven primarily by growth in Monthly Recurring Revenue1 ("MRR"), largely due to an increase in the number of merchants joining the Shopify platform.
- Merchant Solutions revenue grew 58%, to $180.0 million, driven primarily by the growth of Gross Merchandise Volume2 ("GMV"), as well as by robust growth in Shopify Capital and Shopify Shipping.
- MRR as of March 31, 2019 was $44.2 million, up 36% compared with $32.5 million as of March 31, 2018. Shopify Plus contributed $11.3 million, or 26%, of MRR compared with 22% of MRR as of March 31, 2018.
- GMV for the first quarter was $11.9 billion, an increase of $3.9 billion, or 50%, over the first quarter of 2018. Gross Payments Volume3 ("GPV") grew to $4.9 billion, which accounted for 41% of GMV processed in the quarter, versus $3.0 billion, or 38%, for the first quarter of 2018.

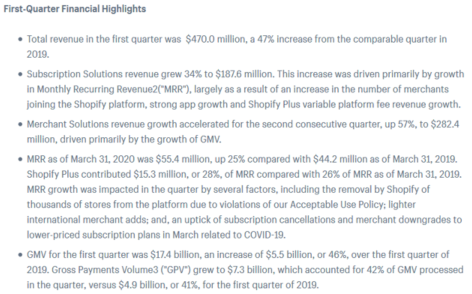
Source: Shopify 19Q1



Fourth-Quarter Financial Highlights

- Total revenue in the fourth quarter was $505.2 million, a 47% increase from the comparable quarter in 2018.
- Subscription Solutions revenue grew 37% to $183.2 million. This increase was driven primarily by growth in Monthly Recurring Revenue1 ("MRR"), largely as a result of an increase in the number of merchants joining the Shopify platform.
- Merchant Solutions revenue grew 53%, to $322.0 million, driven primarily by the growth of Gross Merchandise Volume2 ("GMV").
- MRR as of December 31, 2019 was $53.9 million, up 32% compared with $40.9 million as of December 31, 2018. Shopify Plus contributed $14.6 million, or 27%, of MRR compared with 25% of MRR as of December 31, 2018.
- GMV for the fourth quarter was $20.6 billion, an increase of $6.6 billion, or 47%, over the fourth quarter of 2018. Gross Payments Volume3 ("GPV") grew to $8.9 billion, which accounted for a record 43% of GMV processed in the quarter, versus $5.8 billion, or 41%, for the fourth quarter of 2018.

Source: Shopify 19Q4



First-Quarter Financial Highlights

- Total revenue in the first quarter was $470.0 million, a 47% increase from the comparable quarter in 2019.
- Subscription Solutions revenue grew 34% to $187.6 million. This increase was driven primarily by growth in Monthly Recurring Revenue2("MRR"), largely as a result of an increase in the number of merchants joining the Shopify platform, strong app growth and Shopify Plus variable platform fee revenue growth.
- Merchant Solutions revenue growth accelerated for the second consecutive quarter, up 57%, to $282.4 million, driven primarily by the growth of GMV.
- MRR as of March 31, 2020 was $55.4 million, up 25% compared with $44.2 million as of March 31, 2019. Shopify Plus contributed $15.3 million, or 28%, of MRR compared with 26% of MRR as of March 31, 2019. MRR growth was impacted in the quarter by several factors, including the removal by Shopify of thousands of stores from the platform due to violations of our Acceptable Use Policy; lighter international merchant adds; and, an uptick of subscription cancellations and merchant downgrades to lower-priced subscription plans in March related to COVID-19.
- GMV for the first quarter was $17.4 billion, an increase of $5.5 billion, or 46%, over the first quarter of 2019. Gross Payments Volume3 ("GPV") grew to $7.3 billion, which accounted for 42% of GMV processed in the quarter, versus $4.9 billion, or 41%, for the first quarter of 2019.

Source: Shopify 20Q1

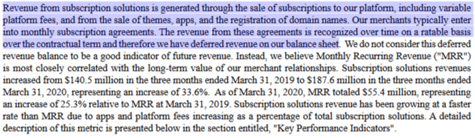
19Q4 Source	**Subscription Solutions**	**Merchant Solutions**	**Total**
Revenue	$183.17 million	$321.99 million	$505.16 million
Cost of Revenue	$37.37 million	$203.90 million	$241.27 million
Gross Profit	$145.80 million	$118.09 million	$263.89 million
Gross Margin	79.60%	36.68%	100%
Revenue Share	36.26%	63.74%	100%
Gross Profit Share	55.25%	44.75%	100%
Growth YoY	37.10%	53.11%	46.89%
Growth QoQ	10.62%	43.12%	29.34%

20Q1 Source	**Subscription Solutions**	**Merchant Solutions**	**Total**
Revenue	$187.61 million	$282.45 million	$470.06 million
Cost of Revenue	$37.71 million	$175.34 million	$213.05 million
Gross Profit	$149.90 million	$107.11 million	$257.01 million
Gross Margin	80%	38%	54.68%
Revenue Share	39.9%	60.1%	100%
Gross Profit Share	58.3%	41.7%	100%
Growth YoY	33.5%	56.8%	46.9%
Growth QoQ	2.4%	-12.3%	-6.9%

Here we can see that total subscription solutions revenue grew to $187.6 million in 20Q1, up 33.5% YoY and 2.4% QoQ. You may also have noticed that total revenue declined 6.9% QoQ and the reason for this becomes clear looking at 20Q1, it's related to merchant solutions. While they note in 20Q1 that merchant solutions revenue accelerated by 57% for the second consecutive quarter, you can clearly see that this increase is YoY and they actually declined 12.30% QoQ. Merchant solutions revenue if you remember is directionally correlated to GMV and you can similarly see its decline of 15.53% from the previous quarter.

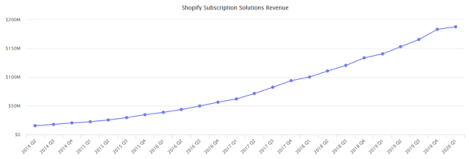
Shopify's Subscription Solutions (8)

Overview



Revenue from subscription solutions is generated through the sale of subscriptions to our platform, including variable platform fees, and from the sale of themes, apps, and the registration of domain names. Our merchants typically enter into monthly subscription agreements. The revenue from these agreements is recognized over time on a ratable basis over the contractual term and therefore we have deferred revenue on our balance sheet. We do not consider this deferred revenue balance to be a good indicator of future revenue. Instead, we believe Monthly Recurring Revenue ("MRR") is most closely correlated with the long-term value of our merchant relationships. Subscription solutions revenues increased from $140.5 million in the three months ended March 31, 2019 to $187.6 million in the three months ended March 31, 2020, representing an increase of 33.6%. As of March 31, 2020, MRR totaled $55.4 million, representing an increase of 25.3% relative to MRR at March 31, 2019. Subscription solutions revenue has been growing at a faster rate than MRR due to apps and platform fees increasing as a percentage of total subscription solutions. A detailed description of this metric is presented below in the section entitled, "Key Performance Indicators".

Source: TSX Filing



Source: Market Place Pulse

Total Addressable Market

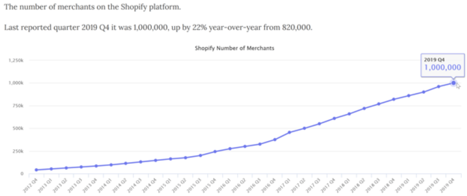
According to BuiltWith, there are a total of 15,563,779 platforms detected across 7,583,817 unique sites. As of July 23 Shopify controls 1,422,815 of these unique sites, meaning that Shopify's growth potential in this area is limited to roughly 5.3x their current share, plus industry growth. Remember that Shopify's revenue in this segment is linearly correlated to the quantity of stores on its platform.

Considering that Shopify generated $187.6 million revenue from this segment 20Q1, we can extrapolate to roughly $994.28 million in potential quarterly revenue, or $3.98 billion annually. Further applying a 20% industry growth rate we can determine that the maximum upper limit for subscription solutions revenue FY20 is ~$4.78 billion. This is obviously incredibly small for a total monopoly, it's only 122.32% above their projected FY20 revenue of $2.15 billion and just over 4% of their $118 billion market cap.

Now of course I'm not suggesting that Shopify is incapable of generating more than this upper limit because, as we have discussed, merchant solutions generates the majority of their revenue. This is despite subscription solutions making up the majority of their gross profit due to margins being twice as high. Rather I am only pointing out that this data suggests they have very little upside in subscription solutions.

Quarterly Store Estimates

Remember that revenue from subscription solutions grows linearly as they increase their quantity of stores, regardless of what its GMV is, so let's use the previously shown financial highlights along with merchant data to see if we can find a connection. Unfortunately, for the first time since IPO, for whatever reason, they did not include the number of merchants last quarter. In any case we can look to historical data to try and find a pattern.



The number of merchants on the Shopify platform.

Last reported quarter 2019 Q4 it was 1,000,000, up by 22% year-over-year from 820,000.

Source: Marketplace Pulse

Because we don't have an official merchant count for 20Q1, we'll have to estimate what it was, and we can't use the current number of 1,422,815 stores due to the quarter ending March 31st, so we'll have to apply a reasonable amount of guesswork. It has been a total of 267 days since they passed one million, adding 422,815 stores since, coming to an average of roughly 1,583 new stores per day. It has also been 114 days since 20Q1 ended so we can simply subtract 180,462 stores from the current count for an estimated total of 1,242,353. However, due to an acceleration of new stores beginning towards the end of 20Q1 it makes sense to revise that number slightly down to 1.15 million.

2019 Q1

- Total of 860,000 unique stores.
- Revenue of $140.5 million in subscription solutions.
- MRR contributed $44.2 million towards that revenue.
- Average store revenue of $163.37 quarterly, $54.45 monthly.
- Average store MRR of $51.40 quarterly, $17.13 monthly.

2020 Q1

- Total of 1,150,000 unique stores.
- Revenue of $187.6 million in subscription solutions.
- MRR contributed $55.4 million towards that revenue.
- Average store revenue of $163.13 quarterly, $54.38 monthly.
- Average store MRR of $48.17 quarterly, $16.06 monthly.

Next Quarter Projections

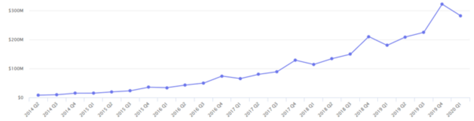
Due to the relatively stable nature of average store contributions, we can use the previously established data to provide projections for 20Q2 as well. In this case, because the fiscal quarter ended 24 days ago, I've revised the total number of stores down from 1.42 million to 1.35 million.

2020 Q2 (Projections)

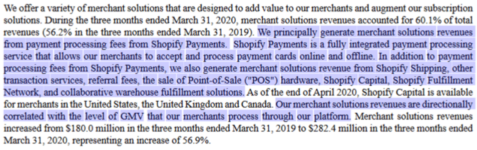
- Total store count of 1,350,000.
- Average store quarterly revenue of $160.00.
- Average store quarterly MRR of $50.00.
- New store growth of 17.39% QoQ, 87.76% YoY.
- Revenue of $216 million in subscription solutions.
- MRR contribution to revenue of $67.5 million.

Shopify's Merchant Solutions (9)

Overview



Source: Market Place Pulse



We offer a variety of merchant solutions that are designed to add value to our merchants and augment our subscription solutions. During the three months ended March 31, 2020, merchant solutions revenues accounted for 60.1% of total revenues (56.2% in the three months ended March 31, 2019). We principally generate merchant solutions revenues from payment processing fees from Shopify Payments. Shopify Payments is a fully integrated payment processing service that allows our merchants to accept and process payment cards online and offline. In addition to payment processing fees from Shopify Payments, we also generate merchant solutions revenue from Shopify Shipping, other transaction services, referral fees, the sale of Point-of-Sale ("POS") hardware, Shopify Capital, Shopify Fulfillment Network, and collaborative warehouse fulfillment solutions. As of the end of April 2020, Shopify Capital is available for merchants in the United States, the United Kingdom and Canada. Our merchant solutions revenues are directionally correlated with the level of GMV that our merchants process through our platform. Merchant solutions revenues increased from $180.0 million in the three months ended March 31, 2019 to $282.4 million in the three months ended March 31, 2020, representing an increase of 56.9%.

Source: TSX Filing

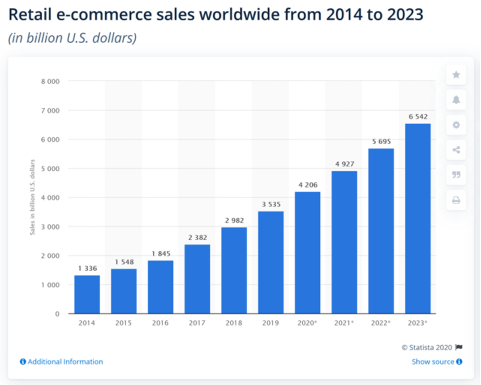
This segment isn't as simple as subscription solutions because it's not linearly tied to the quantity of new stores, but rather their sales volume. Moreover the revenue is split between many more areas and, like subscription solutions, the company provides little breakdown within the segment. However, we do know from company statements, highlighted in the TSX filing image above, that merchant solutions revenue is directionally correlated to GMV so let's see if we can find a pattern.

Source	19Q1	19Q2	19Q3	19Q4	20Q1
Merchant Solutions Revenue (Millions)	$180.00	$208.93	$224.98	$321.99	$282.39
Total GMV (Billions)	$11.90	$13.80	$14.80	$20.60	$17.40
Revenue / GMV	1.51%	1.51%	1.52%	1.56%	1.62%
Total GPV (Billions)	$4.90	$5.80	$6.20	$8.90	$7.30
Revenue / GPV	3.67%	3.60%	3.63%	3.62%	3.87%

Perfect! Every single quarter from 19Q1 to 20Q1 is almost entirely within a tenth of a percent, with 1-2 very minor exceptions, and for both GMV and GPV. You would typically expect GMV to be far less important, but note that Shopify charges a flat 2.0%, 1.0%, or 0.5% fee, depending on the subscription plan, for all third party payment processors, which is in addition to whatever fees the third party charges. Using Shopify Payments has a flat charge of $0.30 per transaction and a processing fee of 2.9%, 2.7%, or 2.4%, again depending on the subscription plan.

Total Addressable Market

This is something that can both be easily determined while being simultaneously useless without context. The simplest starting point is of course the projected retail e-commerce GMV across the globe in FY20. In order to get this we can look to Statista, also referenced by Shopify.

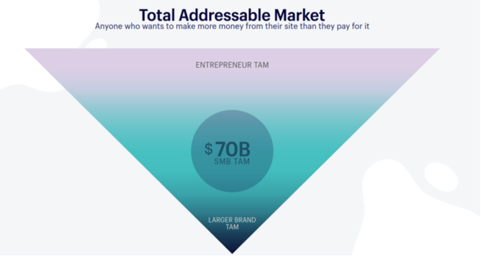


Retail e-commerce sales worldwide from 2014 to 2023

(in billion U.S. dollars)

Whoa! No denying that $4.2 trillion is one big number. Don't get too excited just yet though, remember that we've previously established Shopify generated roughly 1.55% of GMV in revenue. While still an incredibly large number, it drops all the way down to $65.20 billion. This is of course a phenomenal improvement over FY19 merchant solutions revenue of $935.9 million, but it's still only 55.2% of their current market cap and still requires a 100% monopoly on all retail e-commerce sales, which is obviously not even a remote possibility.

Shopify included internal TAM estimates in their 19Q3 investor deck, but it unfortunately does not separate between subscription solutions and merchant solutions and only gives a specific number for SMB's -- $70 billion.



Total Addressable Market
Anyone who wants to make more money from their site than they pay for it
ENTREPRENEUR TAM
$70B
SMB TAM
LARGER BRAND TAM

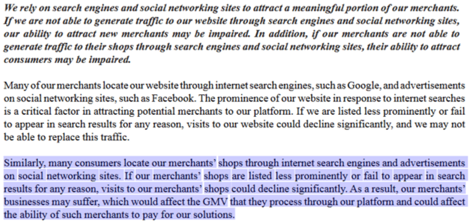
Source: Investor Deck 19Q3

Shopify Payments Runs On Stripe

While this is typically presented as a Shopify product, they don't actually process payments themselves, they use financial services company Stripe for this. The license can be found here, as filed with the SEC, albeit with some important redactions. Interestingly enough Stripe itself is valued at $35 billion as of late last year. Stripe processes payments for many other big names like Lyft and AirBnb, as well as Shopify, and sees hundreds of billions per year in GPV as of late 2019.

Limitations Of Unique Stores

Unlike Amazon or eBay, Shopify is not a centralized storefront, which is by design, allowing merchants to "maintain their brand". However it also means that each store will need to generate its own traffic, and Shopify contributes to this effort. Selling on Amazon has the advantage of nearly a quarter billion unique visitors per month. Obviously Shopify is not only nowhere near this, but more importantly its traffic is spread between nearly 1.5 million separate stores. There will always be an incredibly large percentage of e-commerce sales processed through these central storefronts, further limiting how much of the market Shopify can penetrate.



We rely on search engines and social networking sites to attract a meaningful portion of our merchants. If we are not able to generate traffic to our website through search engines and social networking sites, our ability to attract new merchants may be impaired. In addition, if our merchants are not able to generate traffic to their shops through search engines and social networking sites, their ability to attract consumers may be impaired.

Many of our merchants locate our website through internet search engines, such as Google, and advertisements on social networking sites, such as Facebook. The prominence of our website in response to internet searches is a critical factor in attracting potential merchants to our platform. If we are listed less prominently or fail to appear in search results for any reason, visits to our website could decline significantly, and we may not be able to replace this traffic.

Similarly, many consumers locate our merchants' shops through internet search engines and advertisements on social networking sites. If our merchants' shops are listed less prominently or fail to appear in search results for any reason, visits to our merchants' shops could decline significantly. As a result, our merchants' businesses may suffer, which would affect the GMV that they process through our platform and could affect the ability of such merchants to pay for our solutions.

Source: TSX Annual Information FY20

Conclusions (10)

We have established that, with a 100% market share, the upper limit for subscription solutions revenue FY20 is $4.78 billion. We then also established the upper limit for merchant solutions revenue FY20 is $65.20 billion with an impossible 100% market share on a projected $4.2 trillion in global retail e-commerce. Add these two together and you get a total addressable market of just under $70 billion, which represents just 59.3% of Shopify's current market capitalization of $118 billion.

Due to Shopify's already very high market share in hosted e-commerce, in particular their lead in the highest GMV cohorts, subscription solutions has far less potential than merchant solutions. The issue is of course valuation, how can one justify spending $118 billion now for a total addressable market that's only 59.3% as large?

I still maintain my price target of $118 which would give them a market capitalization of $13.83 billion. This represents 8x trailing sales and 6.4x forward sales, which is still twice as high as Amazon has been in the last two decades. Anything above $186 is completely uninvestable, as this would not only represent more than 10x sales but more importantly represents one third of their estimated TAM across both revenue segments FY20.

Further Thoughts

There are many other areas I would have liked to include but, given both time constraints and the current article size, were not included. Many of these are gone over in more detail in my previous articles, and I may edit this article in the future to include some of them.

- Further analysis on merchant solutions TAM. In this article I made what I feel is a very strong case that the TAM in this segment, which is far more than the TAM for subscription solutions, is still just 55% of Shopify's current valuation. Due to this, it felt redundant to go into deeper detail than necessary.
- Shopify's entire ecosystem centers around their hosted storefront software, it's where the overwhelming majority of their revenue comes from, either directly through subscription solutions or indirectly through merchant solutions. This market is nowhere near as large as many suspect, as I briefly described in this article. This can be used to further narrow down their merchant solutions TAM to a more reliable estimate, but with an upper limit that's just 55% of their current market capitalization I don't know how useful this would be.
- They are a very large reseller, from their POS hardware being rebranded BBPOS devices to Shopify Payments being a rebranded copy of Stripe. Many of their products, virtual and otherwise, act as a reseller.
- Why does Shopify include so little information about each segments revenue breakdown? It's difficult to do a full and proper fundamental analysis when given such broad numbers across just two segments.
- Competition is fierce in the hosted e-commerce space with Woo for example not just growing faster but with a commanding market share lead outside of the top 100k. Shopify's business model relies on penetrating this market further, but particularly in the very limited cohort of the top 10k websites.
- Further analysis of retention rates and growth specific to each cohort. Shopify has the lowest retention rate of all industry leaders with the exception of Wix.
- Further fundamental analysis of each segments individual sources of

revenue. This would include subscription plans, Shopify Plus, Shopify Capital, Shopify Shipping, Shopify App Store, etc.

- Analysis of the companies moat, or rather lack thereof. As earlier mentioned, their entire ecosystem relies on their hosted online stores. The issue is this is an incredibly low barrier to entry by itself. I have described their subscription solutions business model as being closer to Wordpress than Amazon and relying heavily on free and open source software. Well the industry leader WooCommerce is quite literally a Wordpress plugin, free and open source to boot. There is also OpenCart and PrestaShop, two other open source storefront with a combined market share of 7.48%.

Disclosure: I am/we are short SHOP. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Will SHOP slide in the next 2 weeks?

Upgrade to Premium to get exclusive ratings and stay ahead of the curve!

Unlock SHOP Ratings »

Like this article

Follow Oracle Of Alpha and get email alerts

Follow

Recommended for you:

I Put Half Of My Net Worth Into These Investments

Jussi Askola

Very Bad News For REIT Investors

Jussi Askola

Stocks To Watch: Big Focus On Big Tech

SA Stocks To Watch

Amazon: Go Long Into Q2 Earnings, Here's Why (NASDAQ:AMZN)

Michael Wiggins De Oliveira

Comments (11)

+ Track comments Sort by Newest

Tony Montana Munich

Add Your Comment: (NEW! Use @ to tag a user)

Share your comment: ☐ ☐ ☐ Publish

264

Comments (70) | + Follow

I love when this author writes articles on Shopify. Every time he does Shopify makes a new high soon after that. He's consistent with his view for a long time now.

27 Jul 2020, 10:19 AM Like 0 Reply

krokodilica

Comments (125) | + Follow

According to the source mentioned on the link below, Shopify's future TAM is much smaller than predicted here by the author.

It could reach 20B soon, meaning Shopify market cap is 6 times bigger than the total addressable market.

thereformedbroker.com/...

27 Jul 2020, 10:14 AM Like 0 Reply

Chris Lau

Contributor Premium Marketplace Guide

Comments (10814) | + Follow

The bearish call is both gutsy and foolish. $SHOP is the Tesla of online business for *those pivoting from physical stores to online*.

This trend is expanding, the addressable market is expanding, and the stock may give investors a nice return post-earnings this week.

A nice triple already, with more fuel to run higher. (edited)

27 Jul 2020, 10:06 AM Like 2 Reply

Uhle

Comments (209) | + Follow

A few years ago Tobi did not get venture capital because it was estimated that the there are 40000 potential customers only. Guess again...

27 Jul 2020, 09:56 AM Like 2 Reply

Uhle

Comments (209) | + Follow

TAM is growing, their number of services are growing, their market share might grow, revenue per GMV is growing...

I wonder if you really are short...

27 Jul 2020, 09:59 AM Like 1 Reply

Ascended

Comments (374) | + Follow

$118?

27 Jul 2020, 09:49 AM Like 0 Reply

eclass3180

Comments (62) | + Follow

Maybe people would have some respect for u if u didn't forecast a 80% drop in share price. You sound like an absolute clown and like Andrew left is your lover

27 Jul 2020, 09:47 AM Like 8 Reply

> **jcat90**
>
> Comments (243) | + Follow
>
> An 80% drop in share price is not unheard of.
>
> 27 Jul 2020, 10:00 AM Like 1 Reply

Uhle

Comments (209) | + Follow

So despite growing at such speed - with Corona as a catalyst - in your opinion Shopify deserves a EV/S ratio of <15?

27 Jul 2020, 09:41 AM Like 1 Reply

F Maz

Comments (669) | + Follow

I think most bulls see the online market increasing a lot more and way faster than the Author is predicting.

Edit:

To clarify, I agree the stock is overvalued. Now would be a great time for Shop to raise capital. (edited)

27 Jul 2020, 09:34 AM Like 2 Reply

chillside

Comments (287) | + Follow

lol

27 Jul 2020, 09:31 AM Like 0 Reply

Add a comment

Disagree with this article? Submit your own.
To report a factual error in this article, click here.
Your feedback matters to us!