



If Anyone Can Take On Amazon, It's Shopify

Mar. 29, 2021 2:56 PM ET | **Shopify Inc. (SHOP)** | AMZN | 7 Comments | 3 Likes



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Summary

- Shopify trades at a high valuation, but it is a growth stock with a compelling story.
- The main threat to Shopify is Amazon, but I argue here that Shopify offers a different service and is better positioned to create value for the next generation of sellers/consumers.
- The recent sell-off makes Shopify's valuation more attractive, especially since fundamentals keep improving.





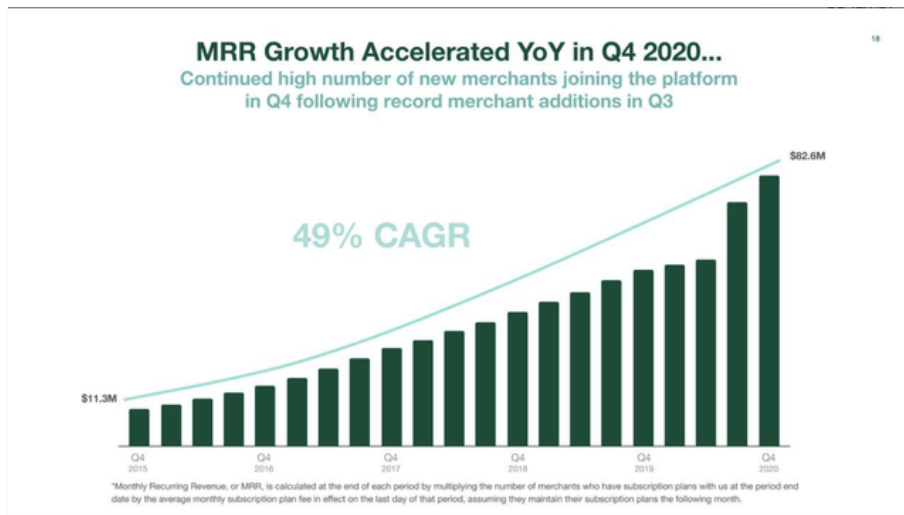
Photo by Klaus Vedfelt/DigitalVision via Getty Images

Thesis Summary

I have written about Shopify Inc. ([SHOP](#)) in the past expressing bearish views on the stock. For more traditional investors it is hard to justify an investment in this company. However, after the recent pullback and latest results things look a bit more promising for Shopify. If we think in terms of who can challenge Amazon in the eCommerce/fulfillment space, the answer is Shopify. And if one believes that Shopify can come out on top, the valuation certainly seems justified as of today.

SHOP: Same price, better numbers

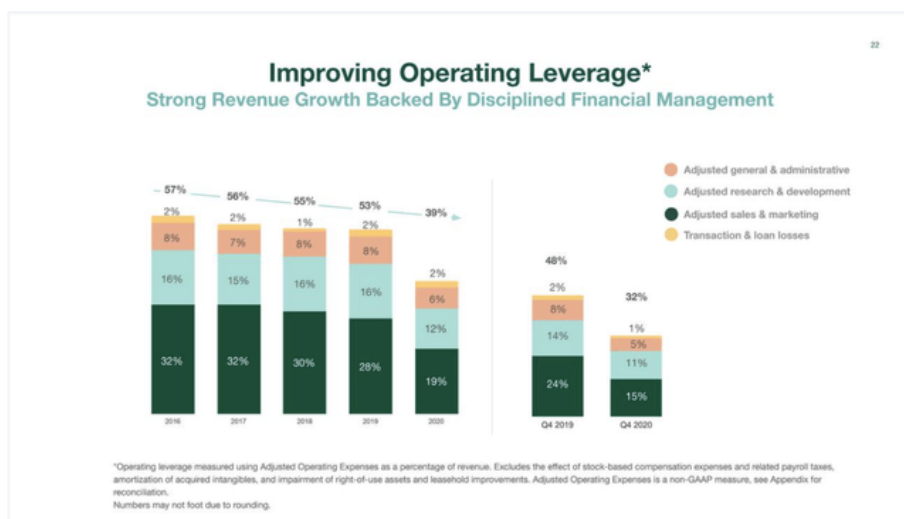
The title of this section refers to Shopify's stock price six months ago, which was pretty close to where it is today after the recent tech sell-off. In a world where stocks don't always follow fundamentals, we now have an equally priced Shopify that has shown continued growth and improved profitability in the last quarter. Granted, one could point out that Shopify showed more improvement in 2020 from Q2 to Q3 than from Q3 to Q4, but there are some obvious reasons for this. The prior period saw a one-time spike in eCommerce transition as we can see the number of new merchants that SHOP added.



Source: [Q4 Results Presentation](#)

I will point out though that Q4 showed evidence that this accelerated growth will continue in the next few years since we can see that the QoQ growth was still higher than in the previous years.

Having said this, we can point out one metric where Shopify has improved: profitability. In Q3, Shopify achieved revenues of \$767.4 million and an operating income of \$62.3 million. Meanwhile, in Q4 revenues were \$977.7 million and operating income \$125.2 million. Therefore, Q3 had an operating margin of 8.12%, while Q4 had an operating margin of 12.8%. Encouraging numbers, and just another in a long line of improvements in profitability.



Source: [Q4 Results Presentation](#)

On top of that, Shopify boasts a gross margin of 52.6%. So, what we have here is a company that has been aided by the secular trends set forth by covid, is increasing its profitability consistently and has grown revenues at over 60% in the last three years. Shopify justifies a premium, and at the very least that premium has gone down significantly in the last six months, while fundamentals keep improving. The only credible threat to Shopify's Cinderella story is Amazon.com ([AMZN](#)), so this is where I'll focus the rest of this piece.

Amazon v Shopify: Two sides of a different coin

Amazon and Shopify compete in the same space but offer very different value to their customers. Before going into detail about this, let's begin by having a look at the bigger picture of the two companies and market:



Source: [Q4 Results Presentation](#)

Amazon dominates the domestic eCommerce market when we look at 2020 sales and Shopify is a far second, but leads a "second-tier" group made up of Walmart Inc ([WMT](#)) and eBay Inc ([EBAY](#)). What is interesting though is that, if we look at market share in 2019, Shopify and Amazon are both continuing to take market share. In 2019, Amazon had a 37% market share, while Shopify had just under 6%. Shopify did grow its market share more proportionally, but Amazon is far from being threatened by Shopify or any other retailer at this point and is still expanding its dominance. If anything, one would think Shopify is under attack from Amazon, as a few months ago Amazon talked about competing more directly with them by [launching a new store format](#).

This is what brings me to my next point. Amazon and Shopify are very different companies; one serves consumers, while the other serves merchants. Furthermore, one of the benefits from the power of scale, while the other benefits from its platform.

Starting with Amazon, the value it offers is to consumers first, and its profitability and growth model are based on Ben Thompsons "[Aggregation Theory](#)". This theory sustains that, due

to the changes that the digital age has brought about, the power lies in those companies that control demand for abundant resources, rather than companies that control the distribution of scarce ones. Amazon is an aggregator and possesses the qualities that are associated with these entities:

- Direct relationship with the consumer
- Negligible marginal cost when serving more users
- Network effect that decreases acquisition cost

The main advantage that sellers get when using Amazon is that they get exposure and can also benefit from Amazon's logistic network. The advantage the consumer gets is lower prices and the convenience of one place where they can find anything they want.

Shopify, on the other hand, is a platform, which makes it a very different beast from Amazon.

A platform is when the economic value of everybody that uses it exceeds the value of the company that creates it. Then it's a platform.

Source: [Bill Gates](#)

Platforms like Shopify or Microsoft ([MSFT](#)) deliver value in a very different way. A platform offers more value than it captures by offering resources and infrastructure. This is where Shopify shines and I don't think Amazon can compete with this. The most significant advantage has is its ecosystem of developers and third-party solution providers. Shopify's app store has thousands of custom-built solutions available at different price ranges

starting at free. Shopify has successfully built an ecosystem which is, in my opinion, what justifies its valuation.

In terms of competition, this means Amazon and Shopify don't compete directly, at least for now. In broad terms, Amazon serves consumers while Shopify serves merchants. The power of Amazon is price, while that of Shopify is differentiation. And that is the key to the competition argument, and why I don't think Shopify can be displaced by Amazon. In reality, I don't think Shopify is interested in competing directly with Amazon. SHOP is focused on continuing to deliver valuable resources to their merchants, rather than capturing demand for them as Amazon does. On that note, I don't believe Amazon could easily disrupt Shopify by offering its competing stores. What money and size can't buy is the years that Shopify has been building its merchant and developer ecosystem.

So, while Amazon and Shopify can both continue to thrive in their respective areas, as an investment, Shopify certainly holds more promise for a couple of reasons. Firstly, because there is less of a ceiling on the value Shopify can offer its users. But most importantly, because I think Shopify's differentiation strategy better aligns with how consumers are buying and interacting with brands/companies.

In [a report by Mckinsey](#), outlining the consumption behaviour of Gen Z, the company points out that GenZ uses purchasing decisions as a way of defining itself. The idea of building a brand and communication is much more important now than ever before. Also, marketing and selling are a part of this. The rise of Instagram has made affiliate marketing and social advertising one of the most prevalent ways of finding and engaging customers. These changes may even affect production.

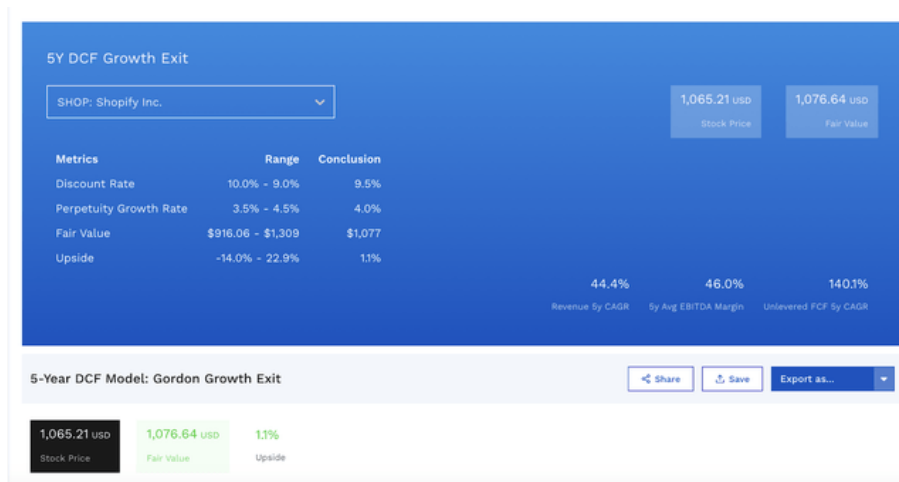
For decades, consumer companies and retailers have realized gains through economies of scale. Now they may have to accept a two-track model: the first for scale and mass consumption, the other for customization catering to specific groups of consumers or the most loyal consumers. In this scenario, not only marketing but also the supply chain and manufacturing processes would require more agility and flexibility.

Source: [McKinsey](#)

In short, I believe we are moving away from the Amazon "mass-produced" model to a more diversified tailor-made approach to selling. Shopify empowers the latter, and while both these models can coexist it is the latter that will generate more value in the future for both consumers and sellers.

Valuation

Having said all this, I believe the company is well-positioned to keep growing and is in fact "protected" from competition from Amazon, as it offers an inherently different service. Shopify is a classic story stock, and I have come to believe in it more and more. However, I thought it would be interesting to use a DCF model to try to justify Shopify's valuation. I used finbox and tweaked the numbers deliberately so that the model would give us a fair value.



Source: [Finbox.com](https://finbox.com)

According to this model, today's price for Shopify would be justified if the company could achieve a 44.4% 5-year growth rate, which is within analysts estimates, and a 46% EBITDA margin. Currently, the company has an EBITDA margin of 8% so this seems highly unlikely. Furthermore, it seems clear that Shopify is not aiming at maximizing its EBITDA margin in the next five years. We have to take this valuation with a grain of salt. But I thought it was interesting to see what it would take for the model to render Shopify a hold.

A more accurate valuation could be made using the P/S ratio. With 39% expected revenue growth, Shopify trades at a December 2021 P/S of 32.36. Over its history, SHOP's P/S ratio has been correlated with its cash flow and profit margin. Despite, the slower growth, improved margins should favour the P/S, and I would expect the TTM P/S to stay in between the 25-30 range. Given the fact that Shopify is still expected to grow near 40%, there is still upside potential even if the ratio declines.

Takeaway

As mentioned above, this is a story stock, and I find myself quite liking the story. I think there is a solid argument that Amazon will


not be able to displace Shopify, and that SHOP has more potential, in the long run, to add value to its merchants. Besides this, Shopify has many other areas of growth it is pursuing. Shop Pay, for example, is now [available on Facebook \(FB\)](#). Overall, the nature of Shopify's business means it is well-positioned to grow from other high growth sectors such as data analytics and AI. An exciting opportunity at a reasonable price.

Disclosure: I/we have no positions in any stocks mentioned, but may initiate a long position in SHOP over the next 72 hours. 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.

3 Likes

7 Comments

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Newest



Tall Seller

Today, 4:02 PM



Comments (11,350)

💥 Shopify's Shop App is NOW the very top ranked shopping related app in Google Play (seen here: [sensortower.com/...](https://sensortower.com/)). And Shopify merchants can also sell on the other top 2)but not the other way around).😂

Shop App & Shop Pay are driving a HUGE amount of merchants to Shopify, as it's helps merchants sell 2-4X the more.



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Joel_Jackson

Today, 4:01 PM



Comments (15)

Shopify will never replace Amazon. As a consumer who uses Amazon every day I don't want to create 10 profiles on 10 different websites to purchase something. I go on Amazon I order my stuff in batches and I receive it mostly within 2 days free of shipping.

I used Shopify to order my Allbirds. It took 2 weeks to arrive and cost me 11\$ shipping. Shopify is a thousand miles away from Amazon. Brands might prefer Shopify, but the consumer doesn't and the consumer always wins.

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Joel_Jackson

Today, 3:53 PM



Comments (15)

2 bullish articles on SHOP today! Meanwhile, insiders are selling their shares at records levels, Barron's published a piece that SHOP is overvalued by 53%, and specialized media reports that SHOP was part of the Ex Tiger Asia HF. Sounds like longs are getting scared. I've been shorting SHOP at 1400,1300,1200 and adding more as it falls.

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Tall Seller

Today, 4:03 PM



Comments (11,350)

No they are not. Have they sold total of 0.000001% of the outstanding shares? NO!

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Tall Seller

Today, 3:03 PM



Comments (11,350)

If you want an EXTREMELY bullish indicator for Shopify listen to this podcast with SHOPIFY, Facebook, and Spotify CEO's

[open.spotify.com/...](#)

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ramirzadeh

Today, 3:00 PM



Premium

Comments (63)

Pump the breaks! Probably hits \$800 soon!

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CassHman0419

Today, 3:24 PM



PRO

Comments (1)

@ramirzadeh is that before or after Lucid hits \$100? You're opinions have been so accurate i just had to ask.

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