

Shopify, Inc.
NYSE:SHOP

Analyst: Dylan Cirrilla
Sector: Information
Technology

Buy

Price Target: 37.07

Key Statistics as of 4/15/2016

Market Price: \$30.97
Industry: Internet Software and Services
Market Cap: \$2061.9 million
52-Week Range: \$42.13 – \$18.48
Levered Beta: 1.85

Thesis Points:

- Takeover target of Google and other tech giants
- Partnerships/Acquisitions will provide expansion into other markets

Company Description:

Shopify, Inc. provides a cloud-based commerce platform. The Company offers a platform for merchants to create an omni-channel experience that helps showcase the merchant's brand. Shopify uses a cloud-based platform that is aimed towards assisting customers with credit card processing without the use of a third party and allows for a portal between the company and its customers. The Company aims to focus on mobile applications and an intimate experience between its clients and its clients' prospective customers. The company's 52-week high was \$42.13 on 6/17/15 with a 52-week low on 1/15/16.



Thesis

Shopify Inc. (NYSE:SHOP) is a company that, while young, shows impressive sales trends, strong management and an effective business model. Fundamentally, the company is in a growth industry and holds a best-in-class status. This will allow SHOP to take advantage of the growth opportunities within the industry more efficiently and more readily than its less desirable counterparts. Management will also bring Shopify to profitability. This has been exhibited through effective M&A activity and prosperous business partnerships with companies like Facebook. For the near-term, management will bring profitability to Shopify through expansion of its service offerings by acquiring useful technologies and increasing exposure through partnership activity. This will create enough organic growth to bring a desirable return over the next year. However, an acquisition by a large firm, like Google, will make this buy a truly special transaction. Shopify's market price on 4/15/16 by market close was \$30.97. With a 1-year target price of \$36.37, there is a 17.4% upside.

Industry Outlook

It's no secret that the Information Technology (IT) is booming. As Deloitte states in an outlook article of the industry¹: "Technology is the backbone of the digital economy. The rate of change and the level of disruption driven by modern technology are exponential." In an increasingly digital world, businesses are relying more and more on technology to generate value. Science and innovation drive the growth within this industry. Advancements in bandwidth capacity, processing power, and an unmatched level of access mean IT is reaching new levels of innovation every second; this compounds on itself to make growth and expansion exponential. The same Deloitte article¹ states: "Partnering strategies are another way for technology companies to grow by providing more opportunity for development of new business models, top-line acceleration, and faster adoption of offerings in the marketplace." This speaks to the future of SHOP and lends support to the idea of growth being generated from acquisitions as well as support for the motives of Google to acquire the company. The article also cites smartphone use as a

major contributor to IT growth in the future. As a growing platform for consumption of information, companies will need to establish a mobile presence for their products and brands; a trend SHOP has taken note of and is actively exploring. Lastly, the Deloitte article addressed the markets that are most likely to emerge in this sector. Cloud-computing was among the most likely to emerge, lending support to the SHOP business model. It is clear that the IT industry is booming and will continue to grow exponentially. The specific markets that will emerge are also conducive to growth for SHOP as cloud-computing and mobile applications continue their expansion.

Philosophy and Business Model

Shopify is a leading cloud-based e-commerce platform designed for small and mid-size businesses with some larger companies taking advantage of the platform as well. The platform is designed to assist customers with setting up a store from top-to-bottom. This includes payment, shipping, web design, and back office functionality across the web, mobile devices, social media, brick-and-mortar locations, and pop-up shops. While the software is designed for small and mid-size businesses, large companies like Budweiser, Tesla Motors, and LA Lakers run on the platform. Shopify offers 4 levels of service to businesses: Lite, Basic, Pro, and Unlimited. These services are charged on a monthly basis for \$9, \$29, \$79, and \$179, respectively. The lowest level, Lite, includes Facebook sales, a Shopify buy button, and Point of Sale system. The upgraded levels include additional features ranging from discount code access, gift cards, and advanced report building capabilities. Costs associated with payment processing are also reduced as businesses upgrade to higher levels ranging from 2.9% at the Lite level to 2.4% at the Unlimited level. For an additional fee, starting at \$500, customers have access to an assortment of Shopify experts who specialize in design, marketing, accounting, and some other business aspects. This is an important service for the longevity of Shopify's customers as many small business owners lack a business background. Shopify also has a unique way of gaining new customers and producing content. To acquire customers, aside from marketing initiatives, the company offers a 20%

¹ <http://www2.deloitte.com/us/en/pages/technology-media-and-telecommunications/articles/technology-industry-outlook.html>

commission to those who refer clients. For content development such as new themes and app development, Shopify opens contributions up to the public. The company will offer up to 70% on each theme and 80% of apps to developers. This is a way for Shopify to acquire new content without keeping developers on payroll or having a tremendous R&D expense.

Competitive Landscape

Competition in SHOP's industry is fierce and there are many competitors present. However, SHOP has a strong competitive advantage and is revered in the industry as being the best ecommerce builder, even in the highly competitive industry. Of all the competitors, there can be a few categories that each fit into. These include open-source, hosted, and drag-and-drop. The first group, open-source, require technical skill as they are developed by the public and other users. This marginalizes a very large portion of SHOP's target market. These services are often basic, as well, as users are expected to customize them with their strong technical skill. Companies that offer products in this category include Magento and WooCommerce which uses the popular WordPress platform. The high level of technical skills required to operate this type of product means that additional costs will be incurred to pay a freelance developer and changes to the site will be slow. The second group, hosted, is the section that SHOP would fall into. These sites are marketed as a "one-stop-shop" for ecommerce building. They handle all of the technical background which means management can be very hands-off. These websites tend to be highly customizable but are more expensive than the other categories. Companies that produce hosted services are Shopify and BigCommerce. The last group, drag-and-drop, are easily marketable and easy to use but somewhat gimmicky in their execution. For companies like Wix eCommerce and Weebly eCommerce, this type of website includes limited customization but is a turn-key product. A customer can start up their company's website and associated portals with limited startup cost and time. To customize, users can simply "drag-and-drop" content, as the name suggests, wherever they want it. However easy it is to use, these sites are limited in their customization and are difficult to adapt to the needs of businesses. Though the industry has many competitors, SHOP is a best-in-class provider of

hosted ecommerce services. The sites produced through Shopify are affordable, highly customizable, are supported by teams of experts, and are easy to use; this combines the positive elements of all of the groups of ecommerce builders into one exceptional builder.

Financials

Valuing Shopify Inc is a unique challenge in that it is a new company in a booming industry. The company's IPO was 5/20/2015 so a full year of financial data is not available or difficult to find in a comprehensive form. However, some figures are easily attained. Revenue growth, for example, has been over 300% since 2013. This has resulted in lower operating income and continued net losses. This is, however, typical for a young company in this growth industry. The primary drivers of the net losses that Shopify has experienced since its inception are SG&A expenses and R&D expenses. Sales and marketing expenses account for 80% of SG&A and 34% of revenue. R&D is also quite high, accounting for 19% of revenue. A combined 53% of revenue is being absorbed by SG&A and R&D; these expenses are crucial to the development of Shopify's products and brand. 100% of R&D expenses were capitalized through proforma analysis and 80% of SG&A expenses were capitalized. Because the company is so young and full financials are not available, a large portion of analysis is done with a fundamental lens; namely industry growth, management, and inorganic growth. These pieces of fundamental analysis put a picture together for the going concern of the firm.

Acquisition Target

Acquisitions, as stated in the Deloitte article, are important vehicles of growth for companies in technology industries. An acquisition would allow for an acquirer to gain access to a new technology, customer base, or other assets without having to develop them themselves. This is especially true in tech industries where R&D expenses can overtake an income statement. In recent articles on sites like

Re/Code², SiliconAngle³, and Geekwire⁴, it is believed that Google has added Shopify to its short list of possible acquisition targets. The sources are cited as people familiar with the acquisition projects. An acquisition typically comes with a premium around 30%, historically. However, according to the same articles and others, it is believed that a Shopify acquisition would require a very large premium. If the historical premium were doubled, say 60%, the Shopify acquisition would be close to \$5 billion. This would result in massive returns for shareholders. The motivation for the acquisition is clear. Cloud-based computing and software is a hot topic in today's technology world. Companies like Microsoft and Amazon already possess cloud technology and have been developing them for a couple of years. To compete with these other giants, Google would need to acquire the best known cloud-based ecommerce builder, Shopify. An acquisition of SHOP would allow Google to use cloud technology outside of the ecommerce builder platform while competing with cloud payment systems like iPay.

Partnerships/Acquisitions

Just as acquisitions and partnerships are essential for the growth of massive companies like Google, it is also crucial for smaller companies like Shopify. Historically, Shopify has had great success with acquisitions that are in-line with the trends of the industry. In 2012, the company acquired Select Start Studios – a mobile software developer – to expand into the booming mobile market. Similarly, the company acquired Jet Cooper, a design studio based on Toronto. This allowed Shopify to provide design services to customers as well as improving pre-made templates. Most recently, in mid-April, Shopify announced its acquisition of Kit CRM. This allows Shopify to develop “conversational commerce”, a popular tech topic as companies like Facebook delve into a more personal interaction with customers who will, in turn, be more likely to buy goods or services. This past performance shows a high level of competency of the management teams and indicates a bright future for expansion into M&A activity. Partnerships are also a crucial way for a technology company to develop its software and gain exposure.

In mid-2015, Shopify partnered with Facebook to improve chat capabilities for customer service purposes. The partnership allowed Shopify to expand its offerings to customers who wanted to provide an automated support system through SMS or Facebook chat. The partnership also allowed Facebook to add its own “buy” button, powered by Shopify. These acquisitions and partnership projects, paired with monstrous earnings surprises (last quarter was 81.48%) shows that management is on track towards bringing profitability to Shopify.

Conclusion

Shopify Inc. (SHOP) is a best-in-class ecommerce builder. The services offered through Shopify are regarded as the best in the business; they are affordable, customizable, high-quality, and supported through continued advising and technical support. Fundamentally, the Information Technology industry is booming, indicating many growth opportunities for SHOP in the future. This will be accomplished through continued growth of the target market, M&A activity, and partnership activity. The booming market will continue to produce the demand for ecommerce building services while M&A activity will expand the breadth of services that Shopify can offer. The partnership activity will increase Shopify's exposure and further integrate its offerings into global ecommerce. While past performance does not necessarily indicate future performance, metrics for managerial competency have more longevity than technical analysis of revenues, margins, etc. A strong management base, competent in the most crucial areas of growth for the company, indicate growth trends for the future. SHOP is a recommended buy at the current market price of \$30.97. With a 1-year target price of \$36.37 there is a 17.4% upside. This will be bolstered by future M&A activity and will explode with at least a 30% premium if acquisition rumors are confirmed. A Google acquisition will make this stock an incredibly profitable endeavor. An acquisition premium added to the organic growth opportunities of Shopify indicate that a 50% 1-year profit is reasonable, if the acquisition goes through.

² <http://recode.net/2016/03/18/google-is-shopping-for-cloud-companies-on-the-list-namely-and-shopify/>

³ <http://siliconangle.com/blog/2016/03/21/google-eyes-triple-acquisition-of-shopify-namely-xactly-to-boost-cloud-portfolio/>

⁴ <http://www.geekwire.com/2016/google-mulls-acquiring-cloud-firms-seeks-compete-enterprise-amazon-microsoft-report/>

Shopify Inc. (SHOP)

CENTER FOR GLOBAL FINANCIAL STUDIES

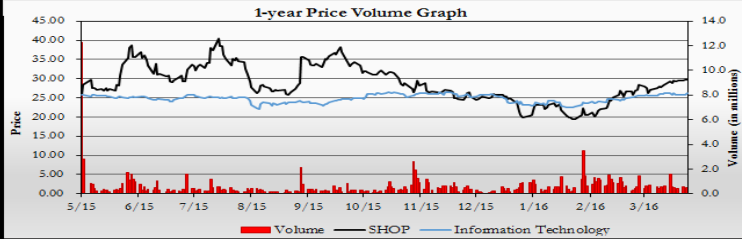
NEUTRAL

Analysis by Dylan Cirrilla
4/16/2016

Current Price: \$30.69
Divident Yield: 0.0%

Intrinsic Value: \$29.87
Target Price: \$36.37

Target 1 year Return: 18.51%
Probability of Price Increase: 89%



Description
Shopify Inc. provides a cloud-based and multi-channel commerce platform for small and medium-sized businesses.

General Information
Sector: Information Technology
Industry: Internet Software and Services
Last Guidance: November 3, 2015
Next earnings date: May 4, 2016
Estimated Country Risk Premium: 5.38%
Effective Tax rate: 23%
Effective Operating Tax rate: 23%

Market Data

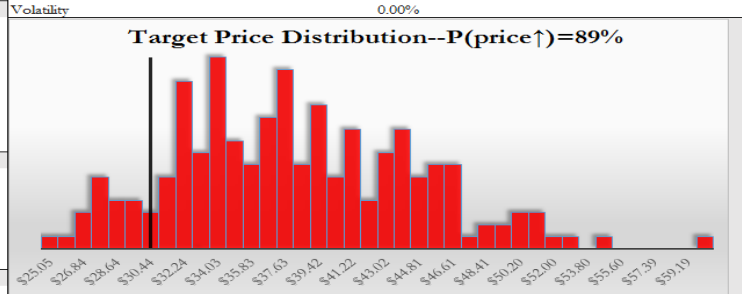
Market Capitalization	\$2,394.16
Daily volume (mil)	0.33
Shares outstanding (mil)	80.34
Diluted shares outstanding (mil)	61.72
% shares held by institutions	38%
% shares held by investments Managers	18%
% shares held by hedge funds	5%
% shares held by insiders	20.02%
Short interest	2.26%
Days to cover short interest	2.46
52 week high	\$42.13
52-week low	\$18.48
Levered Beta	1.79
Volatility	0.00%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2014	N/A	N/A
3/31/2015	N/A	N/A
6/30/2015	17.22%	-178.52%
9/30/2015	9.97%	-209.18%
12/31/2015	9.80%	-9977.97%
Mean	12.33%	-3455.22%
Standard error	2.4%	3261.4%

Peers

Marketo, Inc.
Benefitfocus, Inc.
Demandware, Inc.
Wix.com Ltd.
MINDBODY, Inc.
ChannelAdvisor Corporation
Box, Inc.
Cornerstone OnDemand, Inc.

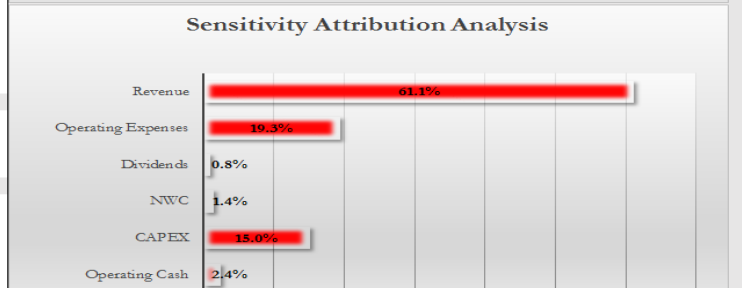


Management

Position	Total compensations growth	Total return to shareholders
Lutke, Tobias Founder, Chairman and Chief	N/M	N/M
Weinand, Daniel Co-Founder, Chief Design Off	N/M	N/M
Jones, Russell Chief Financial Officer	N/M	N/M
Finkelstein, Harley Chief Operating Officer	N/M	N/M
Miller, Craig Chief Marketing Officer	N/M	N/M
Fausser, Cody Chief Technology Officer	N/M	N/M

Profitability

SHOP (LTM)	SHOP (3 years historical average)	Industry (LTM)
ROIC	86.03%	16.31%
NOPAT Margin	#DIV/0!	21.9%
Revenue/Invested Capital	#DIV/0!	0.75
ROE	90.06%	17.45%
Adjusted net margin	#DIV/0!	20.2%
Revenue/Adjusted Book Value	#DIV/0!	0.86



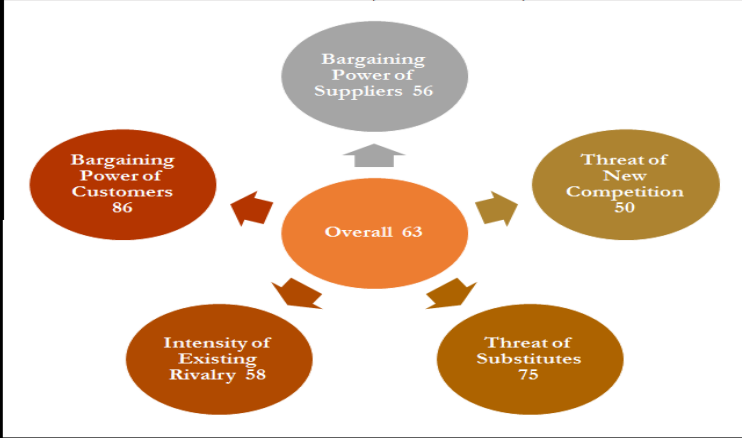
Invested Funds

SHOP (LTM)	SHOP (3 years historical average)	Industry (LTM)
Total Cash/Total Capital	75.8%	68%
Estimated Operating Cash/Total Capital	16.5%	N/A
Non-cash working Capital/Total Capital	-9.8%	-13%
Invested Capital/Total Capital	99.9%	46%

Capital Structure

SHOP (LTM)	SHOP (3 years historical average)	Industry (LTM)
Total Debt/Common Equity (LTM)	0.02	0.08
Cost of Existing Debt	2.76%	2.92%
Estimated Cost of new Borrowing	3.77%	2.92%
CGFS Risk Rating	BB	BB
Unlevered Beta (LTM)	1.79	1.08
WACC	13.79%	9.76%

Porter's 5 forces (scores are out of 100)



Revenue growth

Period	Revenue growth
Base Year	95.4%
12/31/2016	58.4%
12/31/2017	30.8%
12/31/2018	30.1%
12/31/2019	24.5%
12/31/2020	18.6%
12/31/2021	84.1%
12/31/2022	30.1%
12/31/2023	23.1%
12/31/2024	16.1%
12/31/2025	9.1%
Continuing Period	2.1%

Valuation

Valuation	NOPAT margin	ROIC/WACC
Base Year	17.7%	2.17
12/31/2016	19.1%	2.15
12/31/2017	16.1%	0.99
12/31/2018	20.1%	1.19
12/31/2019	21.1%	1.21
12/31/2020	21.4%	1.17
12/31/2021	31.6%	2.69
12/31/2022	26.9%	1.81
12/31/2023	26.0%	1.55
12/31/2024	28.0%	1.60
12/31/2025	29.4%	1.58
Continuing Period	30.0%	1.52

Invested Capital

Period	Invested Capital
Base Year	\$0.00
12/31/2016	\$0.00
12/31/2017	\$18.40
12/31/2018	\$87.28
12/31/2019	\$121.40
12/31/2020	\$214.47
12/31/2021	\$522.68
12/31/2022	\$722.59
12/31/2023	\$944.03
12/31/2024	\$1,200.93
12/31/2025	\$1,452.09
Continuing Period	

Net Claims

Net Claims	Price per share
Base Year	\$219.41
12/31/2016	\$276.11
12/31/2017	\$299.00
12/31/2018	\$288.55
12/31/2019	\$263.75
12/31/2020	\$203.27
12/31/2021	\$246.04
12/31/2022	\$222.22
12/31/2023	-\$246.23
12/31/2024	-\$639.17
12/31/2025	-\$1,248.76
Continuing Period	