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# Shopify's growth path is the biggest unknown as valuation soars

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After a meteoric rise in 2020 that made it Canada's most valuable company, Shopify Inc. has a lot to live up to. The question is whether last year's 178 per cent rally has inflated investors' expectations beyond reason.


Analysts are forecasting record fourth-quarter adjusted earnings of US$150.6 million and the company's first-ever annual adjusted profit when it reports on Wednesday, boosted by soaring demand for online shopping. Longer-term, there's a consensus the Ottawa-based firm is poised to benefit from a massive investment by businesses on a transition to e-commerce.

What's less clear is the trajectory of growth in the medium term, especially once COVID-19 vaccinations let hordes of shoppers break their cabin fever and head back to the mall.

"People are trying to understand the nature of the event that occurred in calendar 2020," Morgan Stanley analyst Keith Weiss said in an interview. "Shopify definitely was an outsized winner during that push toward e-commerce. How durable is that going to be into calendar 2021? That's the key debate."

Weiss expects growth in gross merchandise volume (GMV) -- which represents the value of goods sold through Shopify's platform -- to slow to 34 per cent in 2021 from an estimated 94 per cent last year. That's still above the historical trend but below more bullish Wall Street modeling, which is for an average GMV increase of about 48 per cent, he said.

"High valuations like these necessitate a very high durability of growth," Weiss said. "There's very little margin for error, for any type of deceleration in the overall story." With a market value of almost US$180 billion, Shopify trades at 35 times estimated 2022 sales, according to data compiled by Bloomberg.

**Shutdown of Trump**

Shopify’s dizzying gains -- the Toronto-listed shares have gone up more than 68-fold in five years -- happened as the company’s software became the de facto standard for small businesses looking to set up shop online, well before COVID-19.

As the company broadened its services to include everything from shipping to payments to inventory management, analysts became more focused on the extent to which merchants were willing to pay for those add-ons, known as the “take rate.” The global pandemic shifted the focus back to merchandise volumes, Weiss says, because of the extraordinary impact it’s had on e-commerce.

The shares have jumped an additional 29 per cent in 2021 as the pandemic has lingered and Shopify’s visibility has grown. So far this year the company has won accolades from Elon Musk, made headlines for shutting down online stores affiliated with Donald Trump and signed a partnership with Facebook Inc. over online payments.

More than half of analysts have a overweight or buy rating on the company, including Jefferies LLC analyst Samad Samana.

A strong holiday shopping season bodes well for Shopify’s fourth quarter and will likely be carried over to the first quarter, Samana wrote in a Feb. 7 research note. The fact that PayPal Holdings Inc. and other payment processors reported strong growth is also a good sign. “Continued strength in digital payment volumes are indicative of healthy GMV activity during the fourth quarter, with SHOP being the primary beneficiary,” he said.

Shopify President Harley Finkelstein has said the “paradigm shift” created by COVID-19 in e-commerce is permanent, though he’s also said he expects the pace of Shopify’s growth to slow once the pandemic ends.

For ***Investment Research Corp.’s Chris Silvestre*** -- one of only two analysts with a sell recommendation on Shopify -- that could mean a rude awakening for markets.

“The recent pace of growth is unsustainable, and it’s unclear whether investors are prepared for a material deceleration in GMV and revenue growth,” ***Silvestre*** wrote in a Feb. 3 note. While the stock may trade sideways until its intrinsic value catches up, a 20 per cent price correction is likely over the next six months, he said.

“We believe that the company’s growth will slow materially in mid-2021, disappointing investors and causing share price declines or stagnation.”