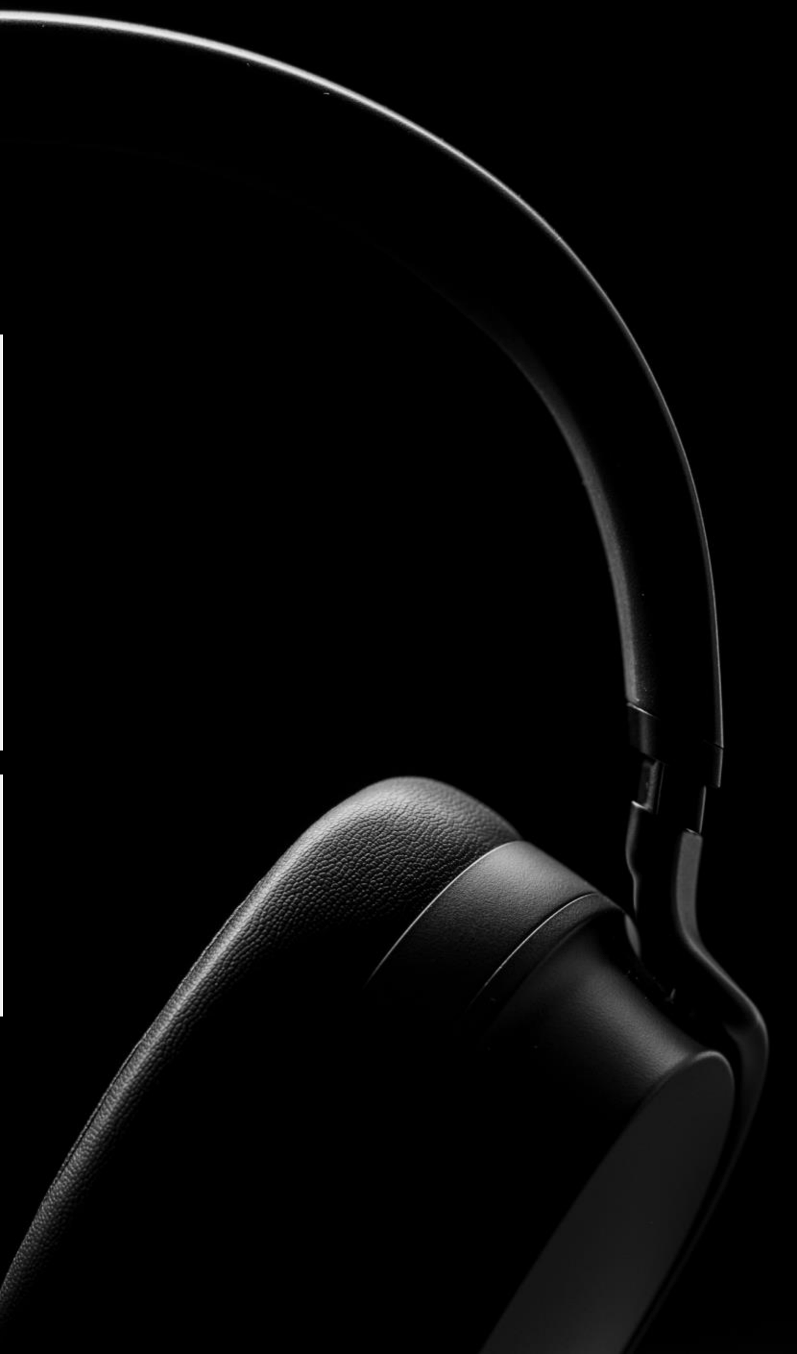
PATIENT CAPITAL

GEDULDIGES KAPITAL



2022

Spotify: The Bear, Base and Bull Case (SPOT:US)

Covesto Patient Capital I ISIN: DE000A2PR0E7 WKN: A2PR0E

@patient_capital

You can find more information on patient-capital.de/fonds

SPOTIFY AT A GLANCE

Ticker: SPOT

Share Price: $173

Dividend: -

Shares (diluted): 195m

Market Cap: $33.1 bn

EV: $31.4 bn

Author: Timo Buss

Disclosure:

Covesto Patient Capital owns SPOT shares since Feb. 2020 at an initial cost of $145 per share

172 Million
PAID PREMIUM SUBSCRIBERS

381 Million
MONTHLY ACTIVE USERS

€10 Billion
REVENUE IN FY21(E)

€21 Billion
PAID TO RIGHTSHOLDERS SINCE LAUNCH

70 Million+
NUMBER OF TRACKS

3.2 Million
NUMBER OF PODCAST TITLES

#1
MUSIC STREAMING SERVICE

#1
PODCAST PLAYER (AAPL IS #2)

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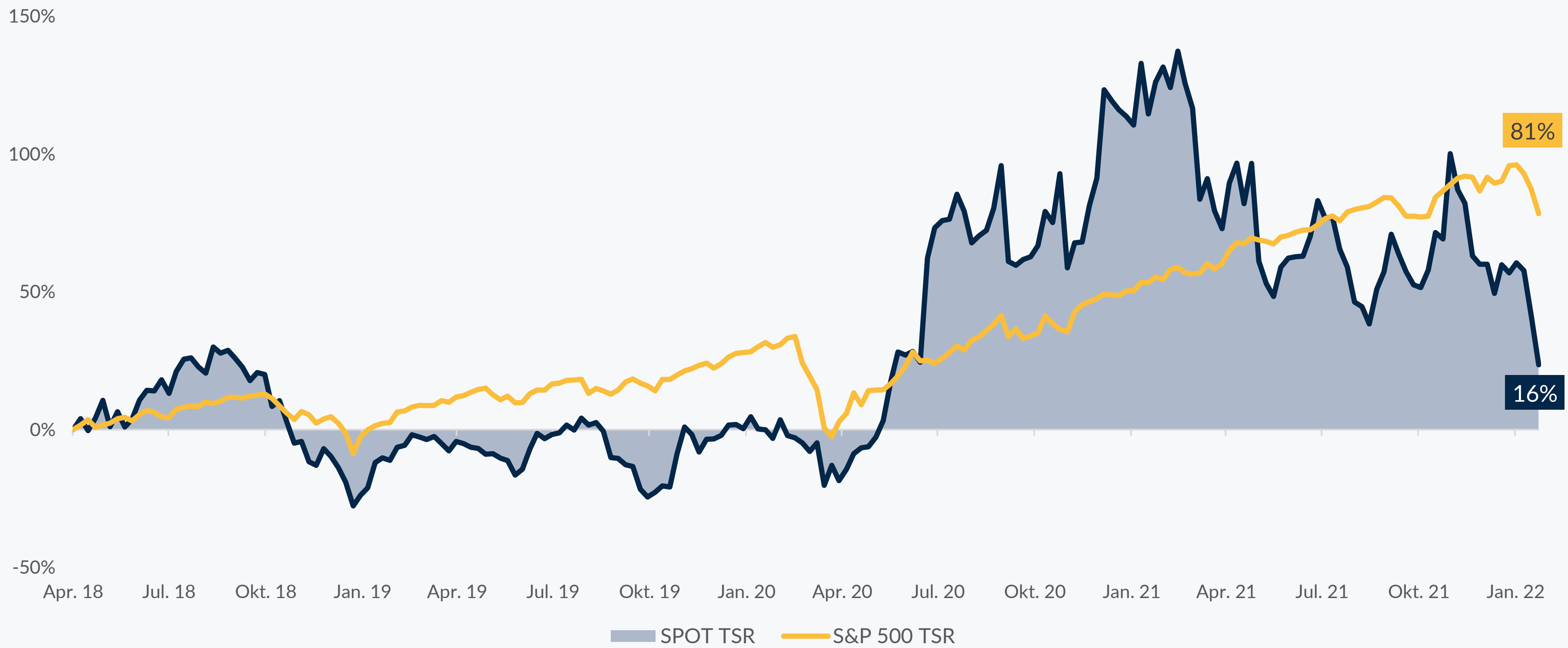
SPOT LISTED IN 2018, UNDERPERFORMING SINCE THEN

SPOT is the leader in music streaming with a 35% global share in paid subscribers. SPOT went public April 3, 2018 through a direct listing. The TSR of +16% is markedly lower than the performance of the S&P 500.

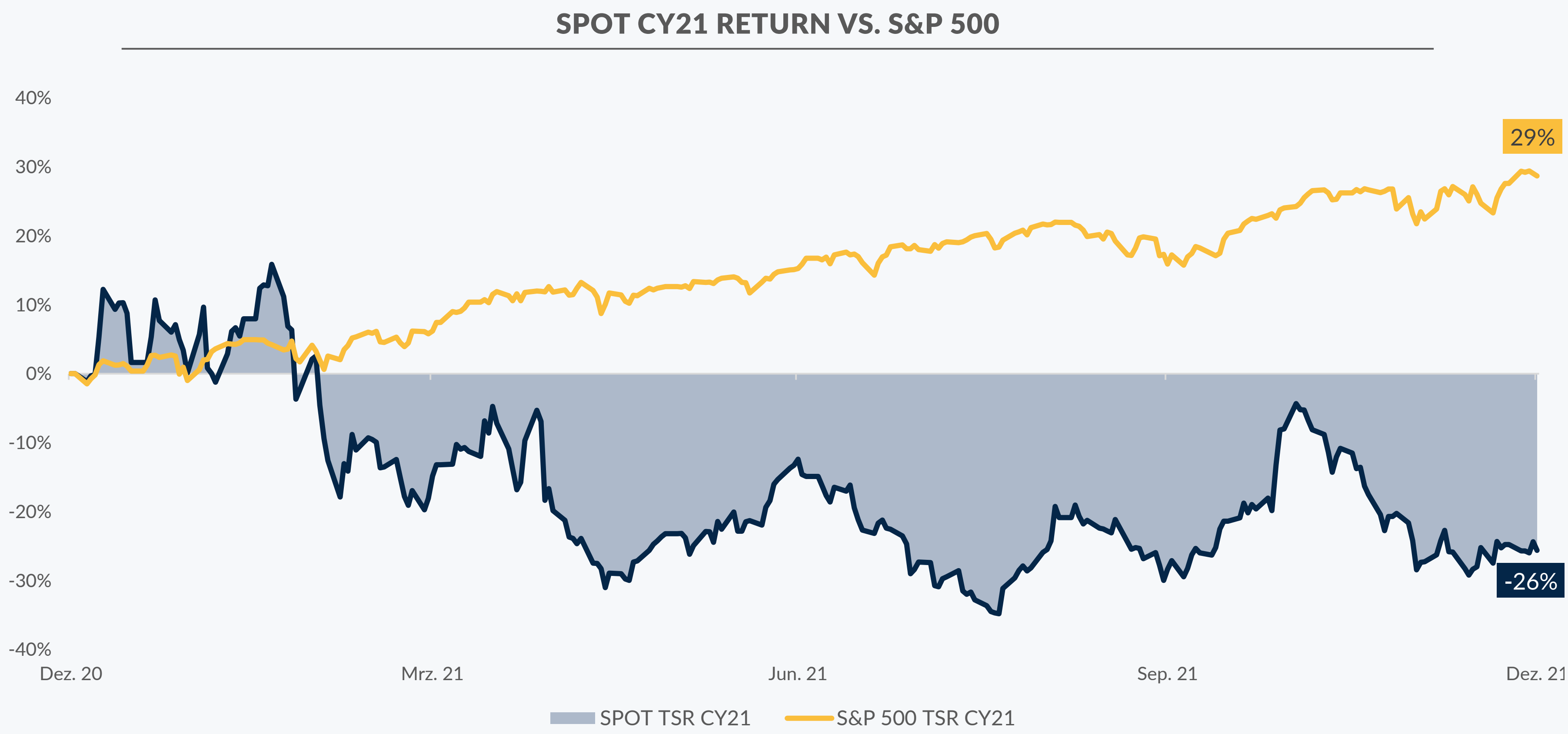
SPOT TOTAL RETURN VS. S&P 500



Data Source: Refinitiv

SPOT'S SHARE PRICE DECLINED SHARPLY DURING 2021

During 2021 SPOT's share price declined 26% compared to an increase of +29% for the S&P 500, which results in a negative delta of 55PP during that time frame. So far, the slide continues in CY22 (YTD: -26%).



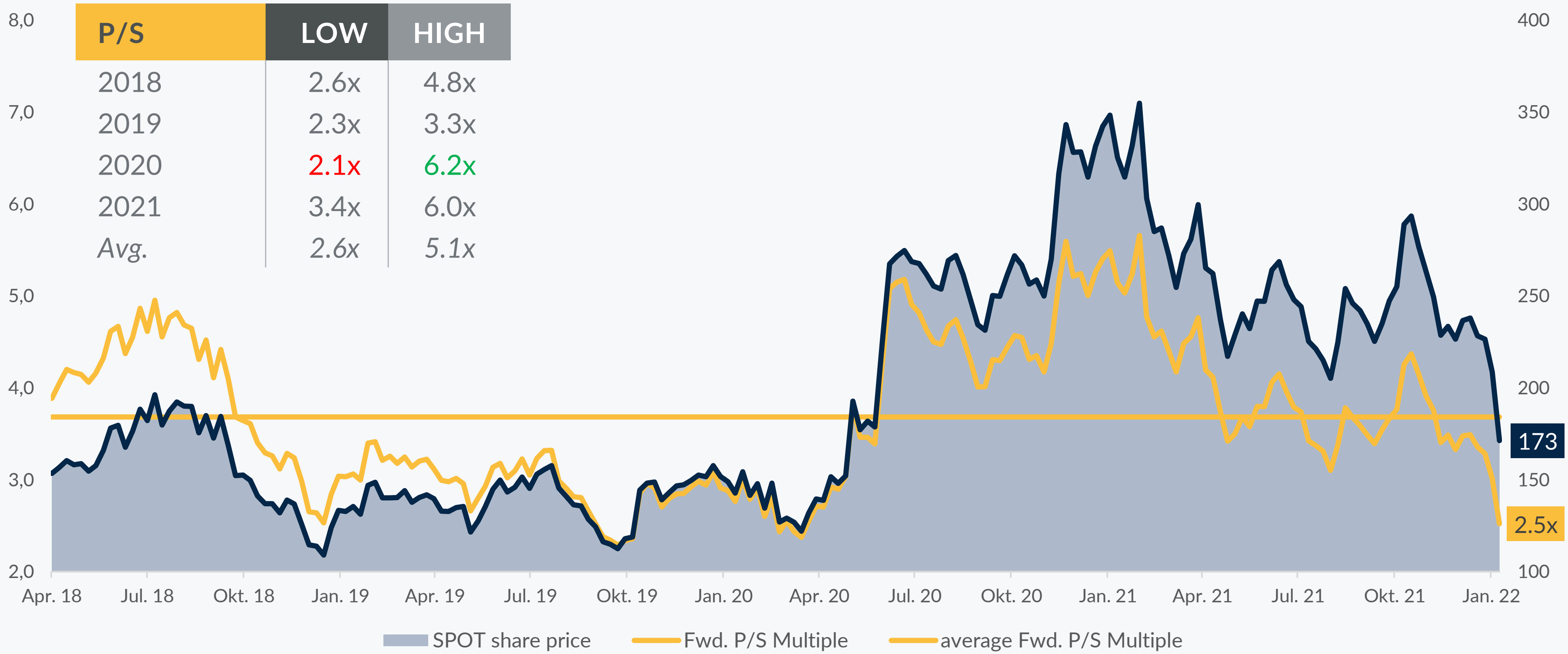
Data Source: Refinitiv

SPOT'S P/S MULTIPLE IS BELOW ITS HISTORIC AVERAGE

SPOT currently trades at 2.5x Rev23(e) and 7.4x EV/Gross Profit23(e), below its historical average. Solely based on prior Fwd. Multiples SPOT would trade near a bottom/top around $167/$441 per share.

SPOT SHARE PRICE AND FWD. P/S MULTIPLE

P/S	LOW	HIGH
2018	2.6x	4.8x
2019	2.3x	3.3x
2020	2.1x	6.2x
2021	3.4x	6.0x
Avg.	*2.6x*	*5.1x*



INVESTMENT CASE HIGHLIGHTS

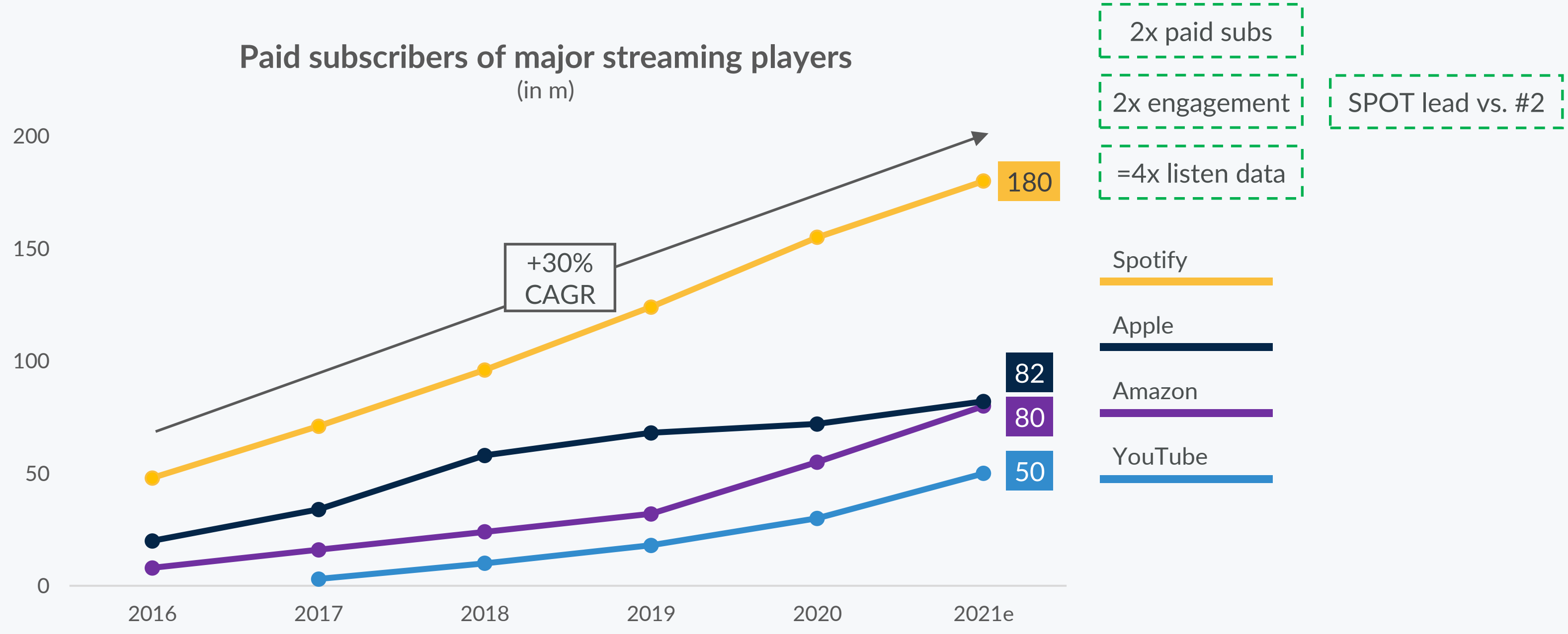
- With 172m paid subs and 381m MAU **SPOT is the clear leader in music streaming**. SPOT is 2x the size of its nearest competitor AAPL in terms of paid subs and has 2x the user engagement (i. e. content hours per user)
- **MAUs spend on avg. ~45 minutes per day on the platform** (80 minutes for paid subs vs. 25 minutes for ad supported users), which makes SPOT one of the most beloved apps in the world. For paid subs the average daily usage time compares well to YouTube (60 min)/WeChat (85 min)/Douyin (90 min)/Netflix (120 min)
- Despite 30% CAGR in MAUs/paid subs/revenue between 2016-2021, **SPOT could easily double its user base to >1 bn MAUs** over the next decade and is set up for annual +11% subs/+15% rev growth until 2030
- SPOT today is solely focused on investing and growing MAUs. **Long term it could possess huge untapped pricing potential with SPOT monetizing at only 9 cents/content hour consumed** vs. 50/90 cents for console games/US cable. In the US, SPOT's standard plan ($9.99/month) is 35% cheaper than NFLX ($15.49/month)
- Despite many tailwinds and SPOT being the category killer, **the company has never turned a full year profit because it has to pay out 2/3 of every dollar to rightsholders** (record labels and music publishers). SPOT's supplier base is highly concentrated with the top 4 labels accounting for 78% of all streams on the platform
- SPOT's exceptional **founder-led management pushes into new adjacencies (especially podcasting)** to loosen the labels' grip on economics. In only three years, **SPOT went from nothing to being the #1 podcast player, which should open up a $18 bn market opportunity by 2030 with 45-50% gross margin** potential compared to <30% for the core business. In my opinion this may transform SPOT into a sustainably profitable business

INTRO

SPOT LEADS STREAMING WITH #1 DISCOVERY AND UX

Offering a vast music back catalogue is a commodity, offering a personalized music streaming service is not. While AMZN/AAPL can bundle/use music as a loss leader, SPOT leads in product focus and ubiquity.

Launch 2008 *Launch 2014* *Launch 2015* *Launch 2015*



THE VALUE OF A BETTER RECOMMENDATION ENGINE

Since content is abundant, the value of most internet platforms shifts from aggregation to discovery and recommendation. SPOT owns new music discovery. Inclusion in SPOT playlists makes or breaks hit songs.

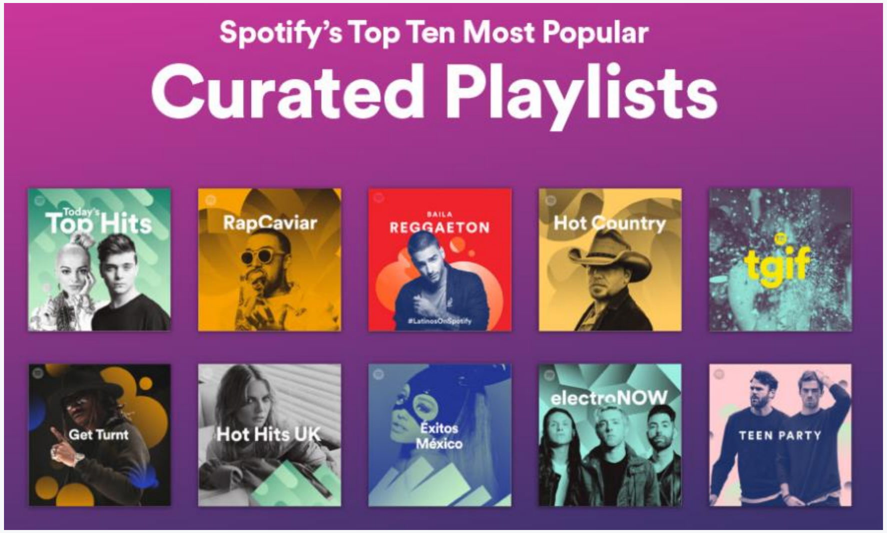
WE BELIEVE A KEY DIFFERENTIATING FACTOR BETWEEN SPOTIFY AND OTHER AUDIO CONTENT PROVIDERS IS OUR ABILITY TO PREDICT MUSIC OR PODCASTS THAT OUR USERS WILL ENJOY. OUR SYSTEM FOR PREDICTING USER PREFERENCES AND SELECTING CONTENT TAILORED TO OUR USERS' INDIVIDUAL TASTES IS BASED ON ADVANCED DATA ANALYTICS SYSTEMS AND OUR PROPRIETARY ALGORITHMS"

- SPOTIFY, 10-K

PLAYLIST INCLUSION CAN CHANGE AN ARTIST'S CAREER

SPOT's own editorial and algorithmic playlists power >30% of all listening on SPOT. Rap Caviar and Viva Latino have more listeners than large radio stations. Playlist inclusion makes new stars like Gashi or Khalid.

- *"If you want to be discovered and for your streaming numbers to go up being on a playlist is pretty much vital. As this allows you to reach thousands and upwards of listeners who like your style of music. You do find these listeners on Instagram but at a much slower rate and for example just because this potential listener likes rap, they may not like your style of rap. [...] **It's not exploded for us though because we've never managed to get on the biggest playlists. That's what could really make a difference to an artist**"* - Jack Biddle artist interviews
- In 2016 SPOT supposedly did not support songs in their playlists that were pre-released exclusively on Apple Music. Industry observers linked this behavior to some high-profile failures like Katy Perry's "Rise"



Source: Spotify, Jack Biddle

WHAT COULD MAKE SPOT'S FLYWHEEL SPIN FASTER?

Each DSP boasts roughly the same music catalogue (no differentiation). However, the quality of new music recommendation is superior at SPOT vs. #2. Also original podcasts ("O&Es") are becoming relevant USPs.

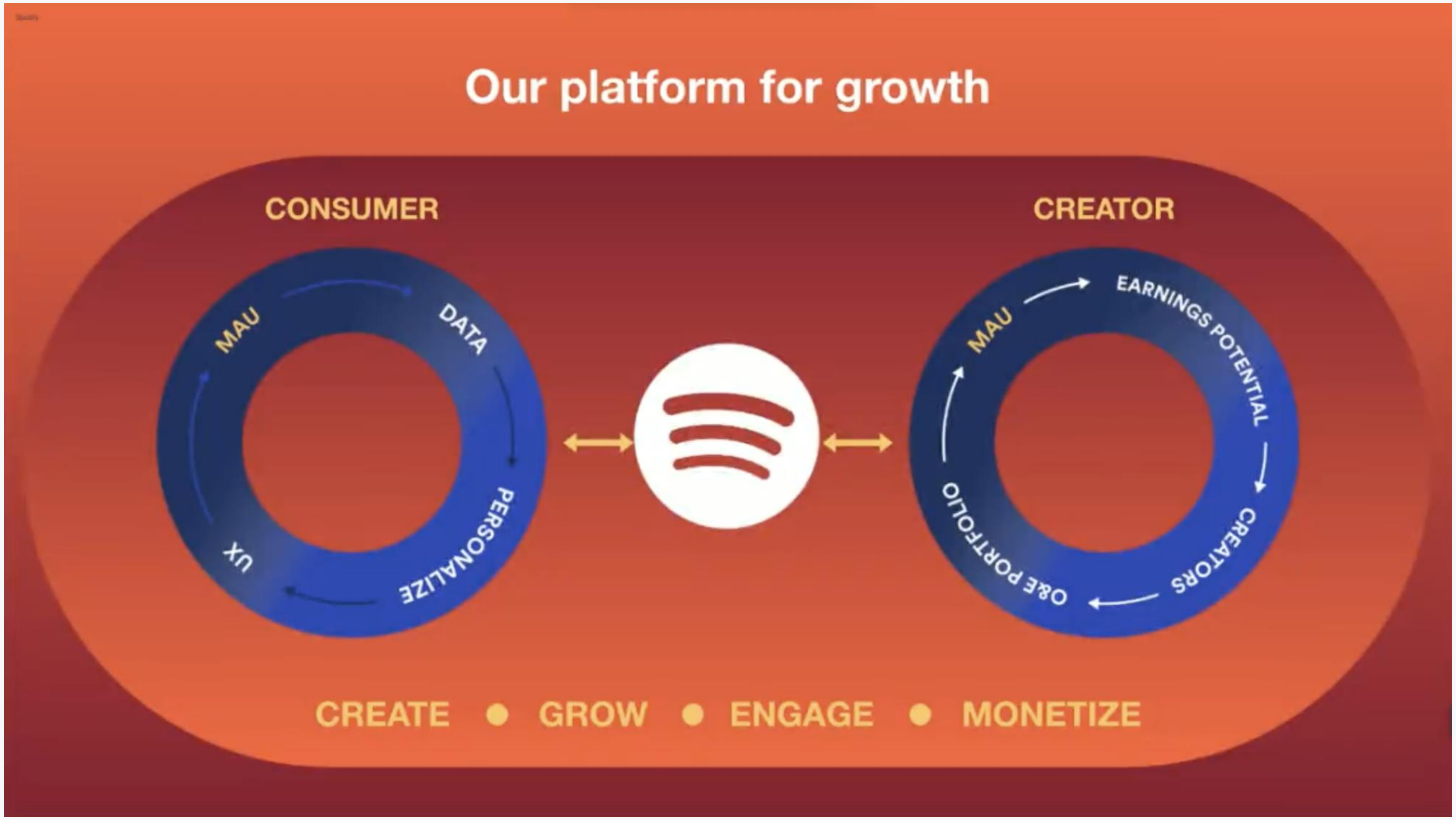
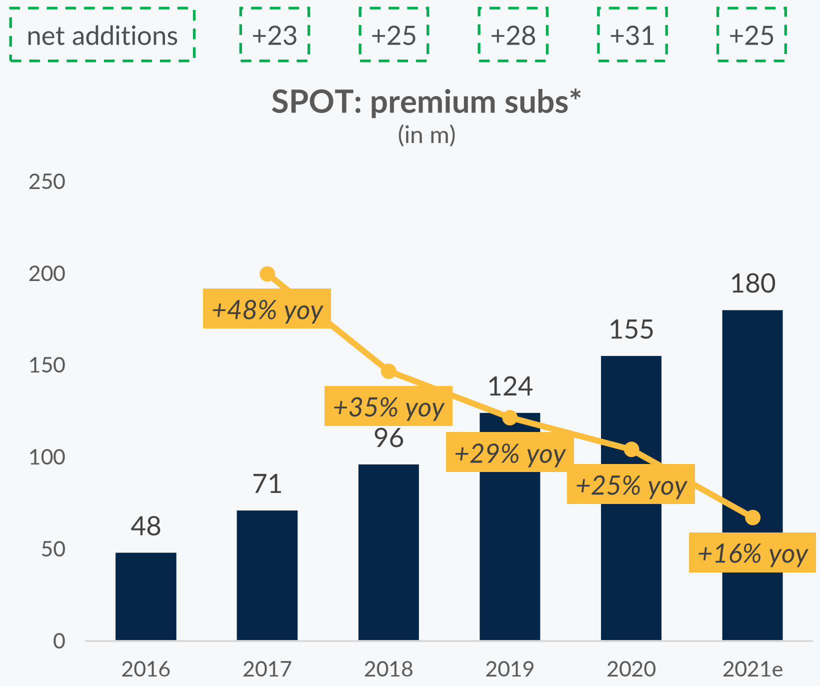
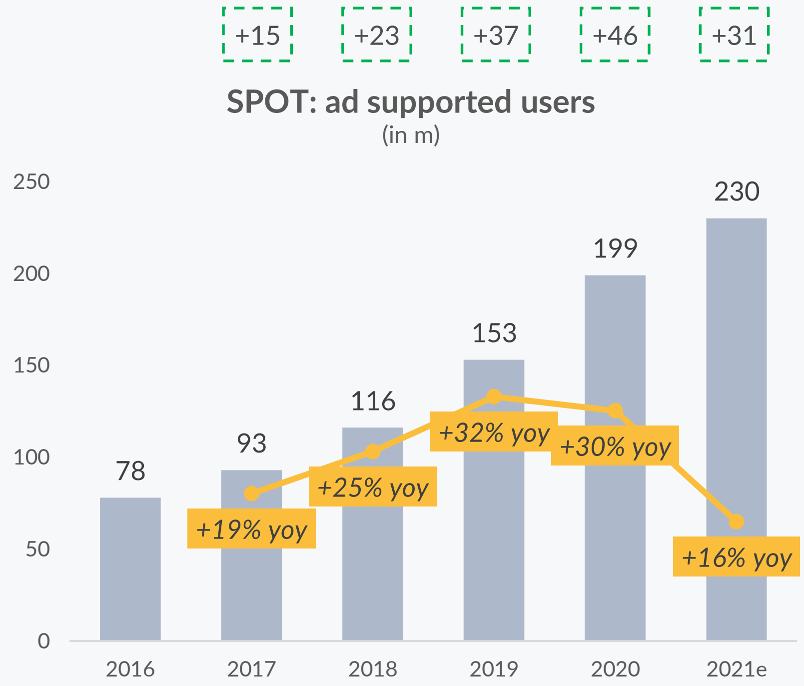


Image Source: Spotify

SPOT DELIVERS STEADY NET ADDS IN PREMIUM SUBS

SPOT operates a freemium model. Premium subscribers pay $9.99/month for an ad-free music listening experience. 2020 saw some pull-forward effects and 2021 is supposed to bring in +25m paid subs (+16%).

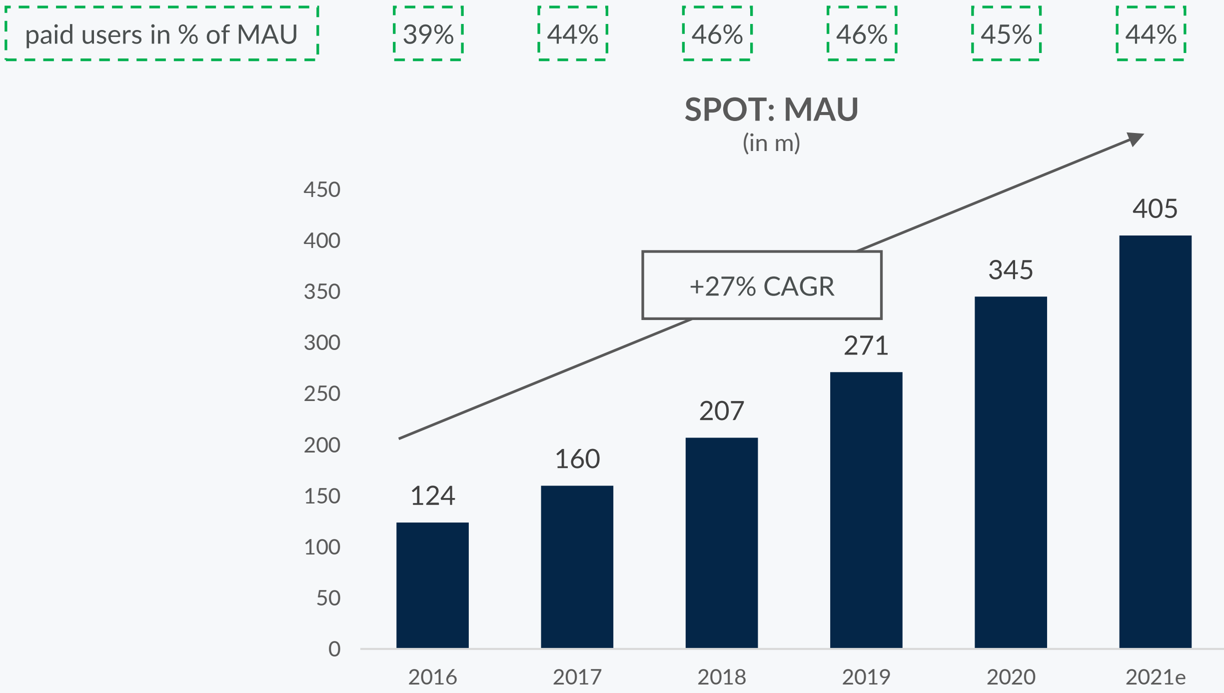




*note that not 100% of paid subs are actually paying, only 60% do. The rest are subs within duo/family plans; Data Source: company reports, own estimates

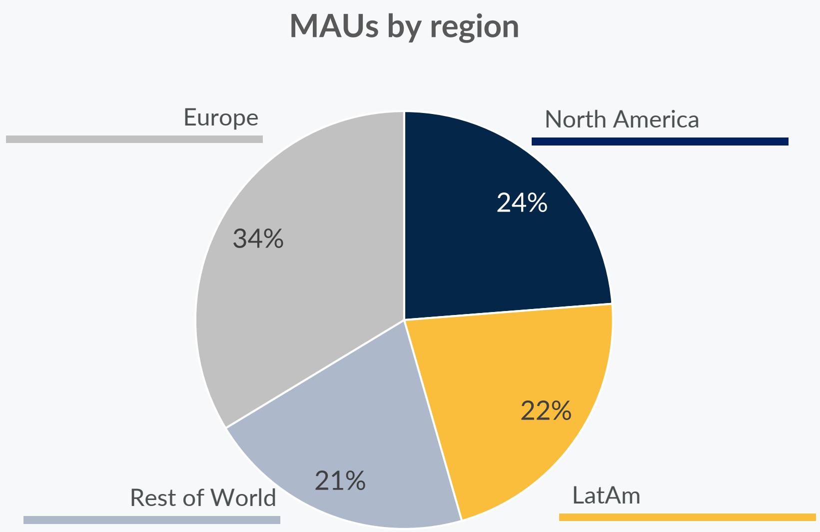
AD TIER SERVES AS SUBSCRIBER ACQUISITION FUNNEL

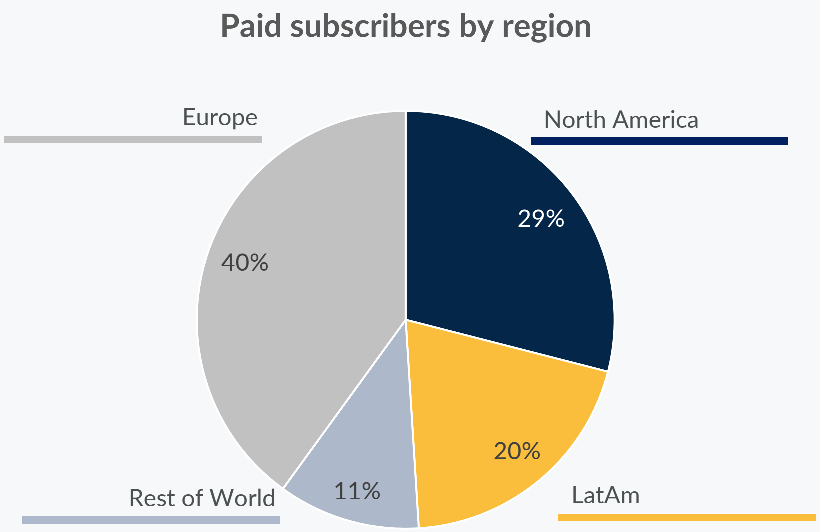
60% of SPOT premium users start in the free ad tier and paid user conversion stands around 45% over the last quarters. Historically, it takes 6 to 18 months for a new ad-funded user to convert to paid premium.



SPOT IS IN 184 MARKETS, MOST MAUS ARE FROM EU/US

SPOT is a global company with ~70% of paid subscribers coming from Europe and the US. Going forward substantial sub growth will come from Asia (ex China), LatAm and Africa (albeit at lower price points).





THE WAY TO 1 BN INDUSTRYWIDE SUBSCRIBERS

2020 saw a total of 443m paid music subscribers worldwide with SPOT leading the pack with 155m paid subs (35% share). This means only 10% of global payment enabled smartphones are penetrated thus far.

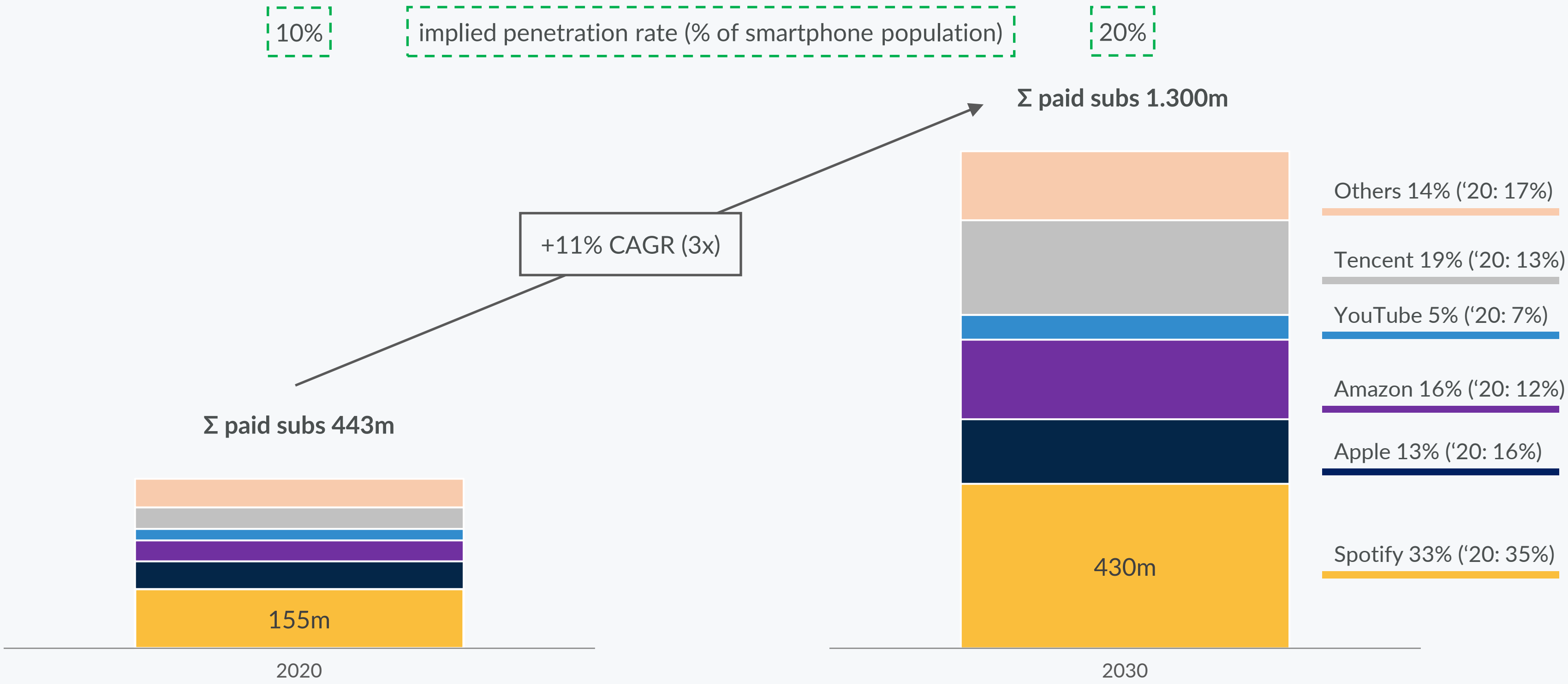
- Until 2030 I believe **industrywide penetration can grow from 10% to 20% (implying a total of 1.3 bn paying subs)**. Early adopter markets like Sweden show paid user penetration rates of ~50%. Subs growth will shift towards EM, but ¾ of paid streaming revenues should still come from DM (because of vastly higher ARPU)

- **40% of all music consumption happens at work or in the car**. Rising penetration rates in EVs/connected cars and wireless headphones/Airpods will shift ear share from linear audio to on demand streaming. Further, the democratization of spoken word audio generation (podcasts) will create a plethora of niche content, which will drive more long tail users to streaming DSPs. **SPOT sees at least a 5x growth potential in its core biz**:

- *"And while we decided early to go all-in on audio, it's giving us a head start of more than a decade and unrivaled size and scale. Others are, of course, taking notice. This isn't surprising at all given the enormous* ***size of the audio market, which some projections indicate could be valued at $200 billion by 2030****. Competition is nothing new for us. We saw it in music and always expected others to jump on the audio train when they realized how attractive it is to billions of listeners around the world.* ***We believe we have at least 5 to 7x growth left in the business we are in today: music, podcasting and paid audio, and we intend to win in those businesses****. All that said, you should expect us to remain focused on our core pillars. For consumers, this is delivering a great consumer experience through freemium, ubiquity and personalization. And for creators, it is a maniacal focus on serving them through a personalized marketplace set of offerings and not one size fits all. As always, when we see opportunities that we believe will strengthen our capabilities for creators or consumers, you should expect us to prioritize the long term over the short term."* – Daniel Ek, Q2/21 Earnings Call

A RISING TIDE LIFTS ALL BOATS

Not only SPOT will benefit from an industrywide growth in streaming. TME is showing increasing success in converting free MAUs to paying users and may become the #2 player in 2030 (19% share vs SPOT 33%).

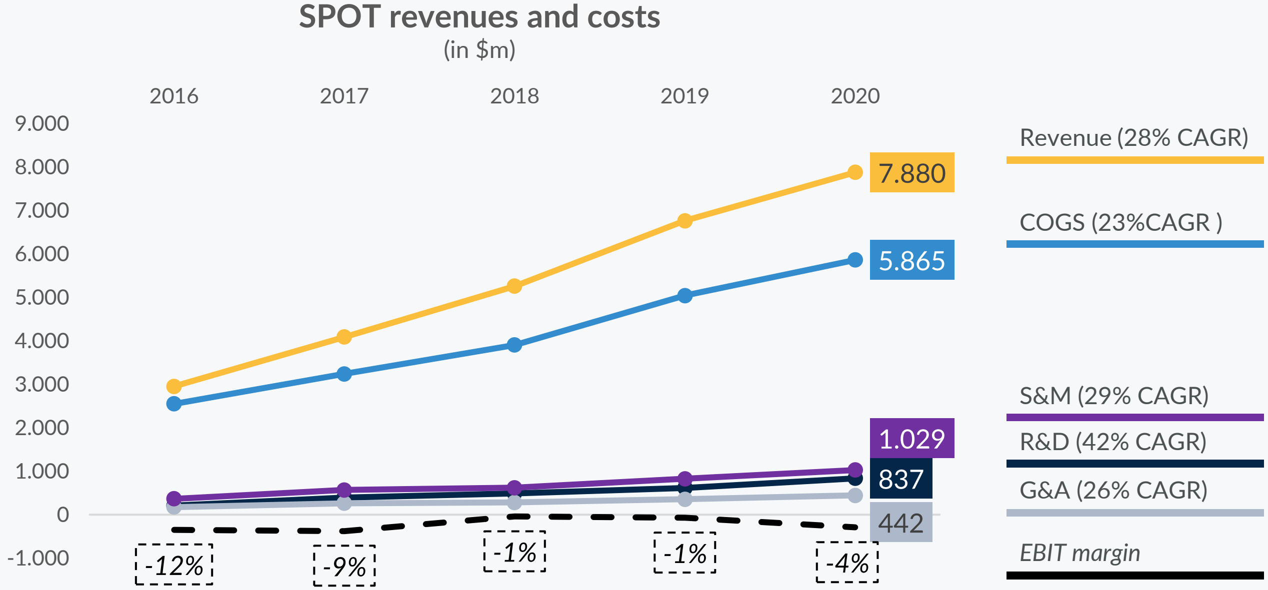


Source: company reports, IFPI, own estimates

HIGH VARIABLE COSTS MAKE A BAD CORE BUSINESS

The industry growth isn't value accretive per se. SPOT's core business is still unattractive due to high variable costs. While Meta leverages free UGC ad inventory, SPOT has to pay high royalties *everywhere*.

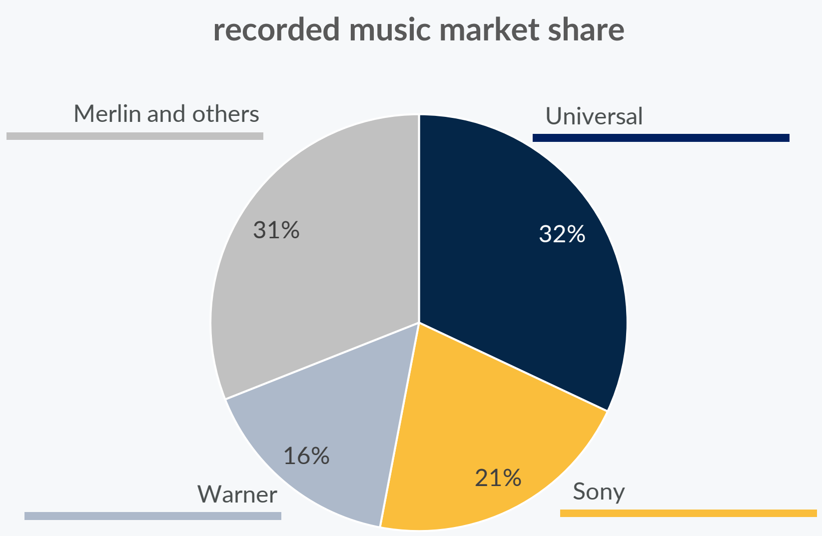
	2016	2020
Revenue	100%	100%
COGS	86%	74%
Gross Margin	*14%*	*26%*
R&D	7%	11%
S&M	12%	13%
G&A	6%	6%
Total OPEX	*25%*	*29%*
EBIT margin	*(12%)*	*(4%)*

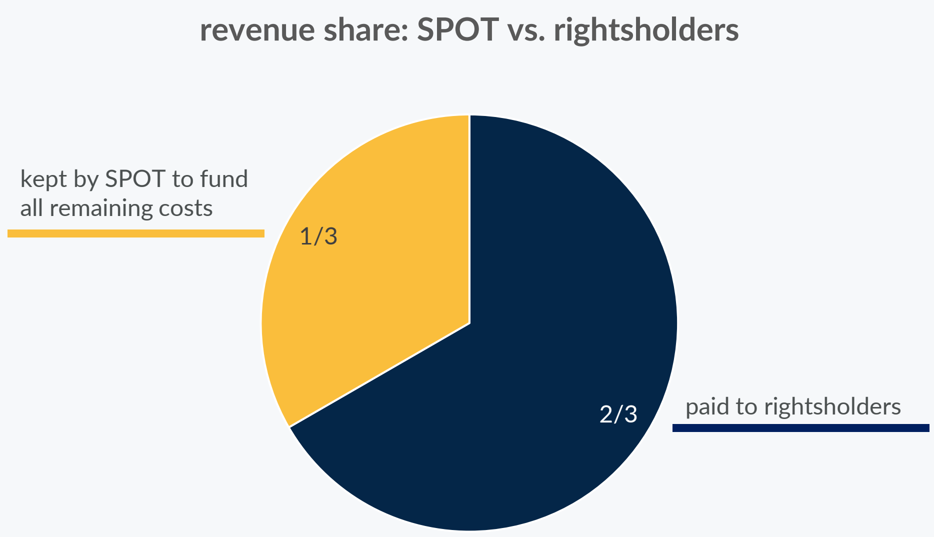


THE BIG 4 LABELS TRY TO SQUEEZE SPOT…

Ben Thompson of Stratechery once declared that *"The value of tech companies is often inversely proportional to the value of the publishers"*. The high value of UMG, SME and WMG in music is an obvious obstacle.

- 78% of all music consumed on SPOT is supplied by UMG, SME, WMG and Merlin
- 60%+ of all music listening is generated from the back catalogue (released >3 years ago). Labels leverage this **revenue stream for which all production and marketing costs have already been paid, to invest in new A&R and protect their future market positions/negotiating power**





Source: company reports

…BUT THE BALANCE OF POWER SHIFTS TOWARDS SPOT

62% of total recorded music revenues already come from streaming (2030e: 89%). SPOT accounts for 20% of the major labels' revenue (2030e: 30%). Labels may soon not be able to play tough anymore with DSPs.

"OUR LICENSE AGREEMENTS WITH DIGITAL MUSIC SERVICES GENERALLY LAST ONE TO THREE YEARS. IN FISCAL YEAR 2020, RECORDED MUSIC REVENUE EARNED UNDER LICENSE AGREEMENTS WITH OUR TOP TWO DIGITAL MUSIC ACCOUNTS, APPLE AND SPOTIFY, ACCOUNTED FOR APPROXIMATELY 34% OF OUR TOTAL REVENUES. SINCE THE EMERGENCE OF DIGITAL FORMATS, OUR BUSINESS HAS BECOME LESS SEASONAL IN NATURE AND DRIVEN MORE BY THE TIMING OF OUR RELEASES."

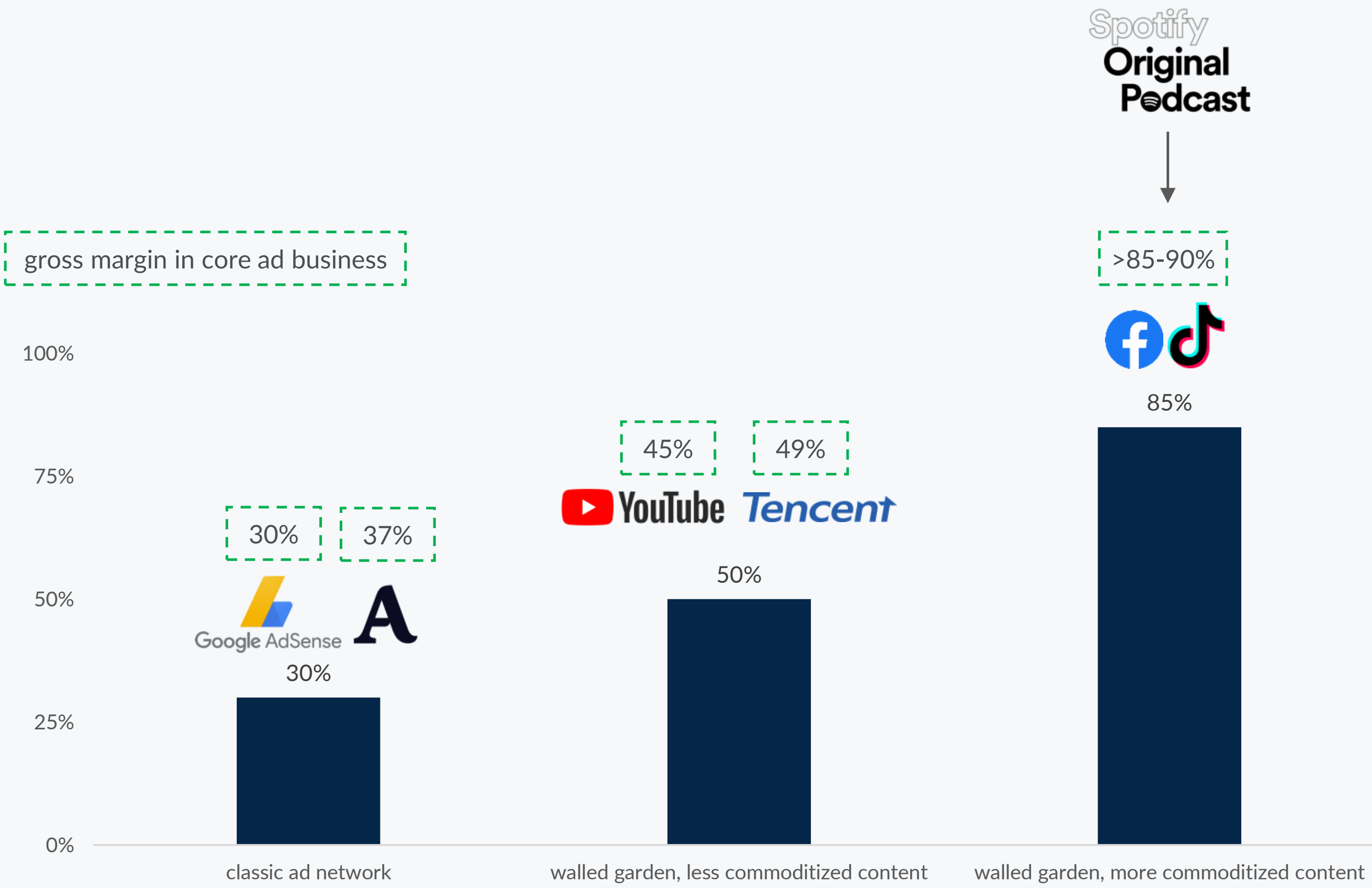
- WARNER MUSIC GROUP, 10-K

"CONTINUED GROWTH OF PAID SUBSCRIPTION STREAMING REVENUE PROVIDES MORE RESILIENT RECURRING REVENUES FOR UMG, WITH STREAMING AND MUSIC PUBLISHING REPRESENTING OVER 67.5% OF UMG'S REVENUES IN 2020. AS THE RECORDED MUSIC INDUSTRY HAS TRANSITIONED FROM A PHYSICAL AND DIGITAL OWNERSHIP MODEL, TO PAID SUBSCRIPTION AND ADVERTISING BASED STREAMING MODELS, UMG'S REVENUES HAVE REFLECTED THIS SHIFT. IN RECORDED MUSIC, 64% OF UMG'S 2020 REVENUES CAME FROM STREAMING AND SUBSCRIPTION, WHICH FIGURE WAS 59% AND 54% IN 2019 AND 2018, RESPECTIVELY.

- UMG, IPO PROSPECTUS

THE MOVE INTO PODCASTS MAY LIFT SPOT'S MARGINS

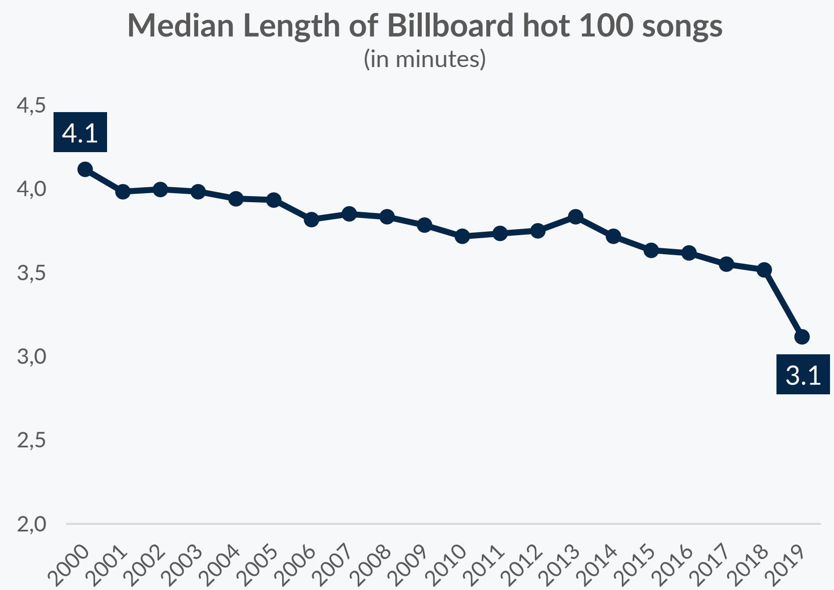
SPOT's core music margin only expands if the two-sided marketplace sees more uptake. Podcast content however is more commoditized/fixed cost. It could soon generate +90% GM on incremental O&E ad sales.



INDUSTRY BACKGROUND

DISTRIBUTION TECH ALWAYS SHAPED MUSIC ITSELF

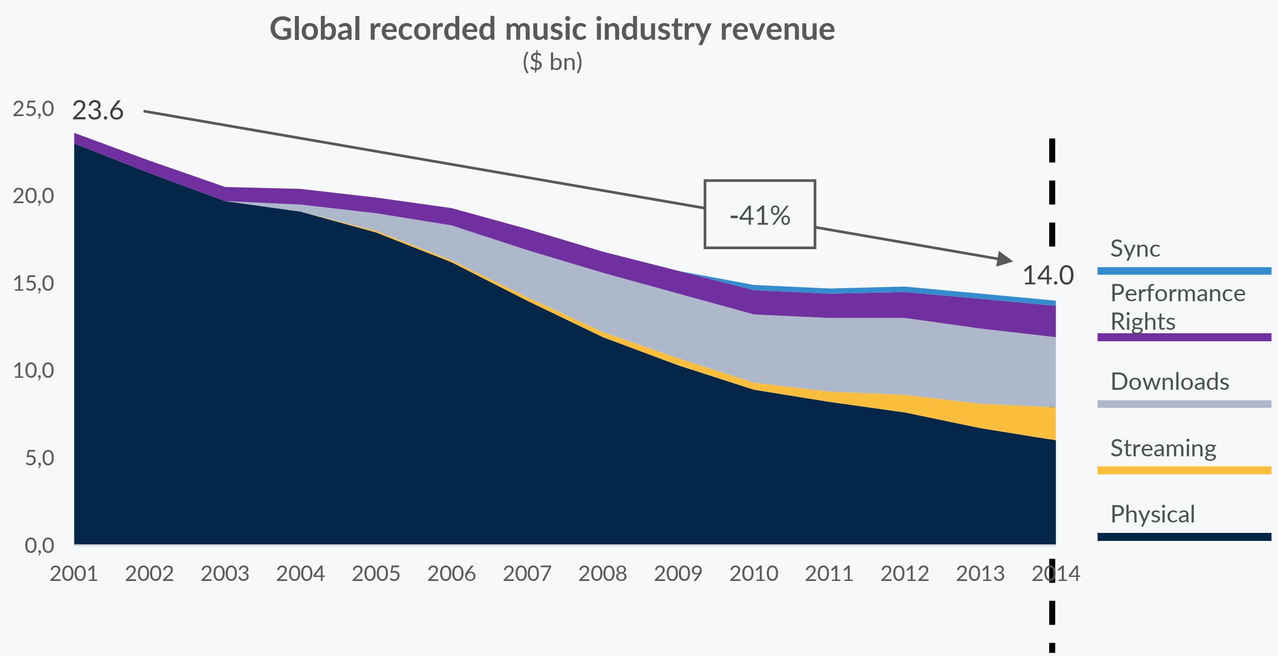
- The advent of the [7“ 45 RPM vinyl single in 1949] marked the end of the 10“ 78 RPM vinyl single
- The 7“ was cheaper to produce and **held roughly three minutes of music**, therefore the entire single production circled around this format
- The **invention of cassettes and CDs freed the recording industry from physical limitations** and the average single length grew from 3 to 4 mins
- The release of iTunes in 2001 led to “the great unbundling of the album” (i. e. $0.99/song) and created **strong incentives to create more singles, multi-section tracks, preludes and skits**
- Today in streaming, DSPs pay rightsholders based on streamshare (# of streams by a particular rightsholder/total streams). Only streams over 30 secs count. To **maximize streamshare artists are reducing single lengths again from 4 to 3 mins**



Data Source: Billboard, RollingStone

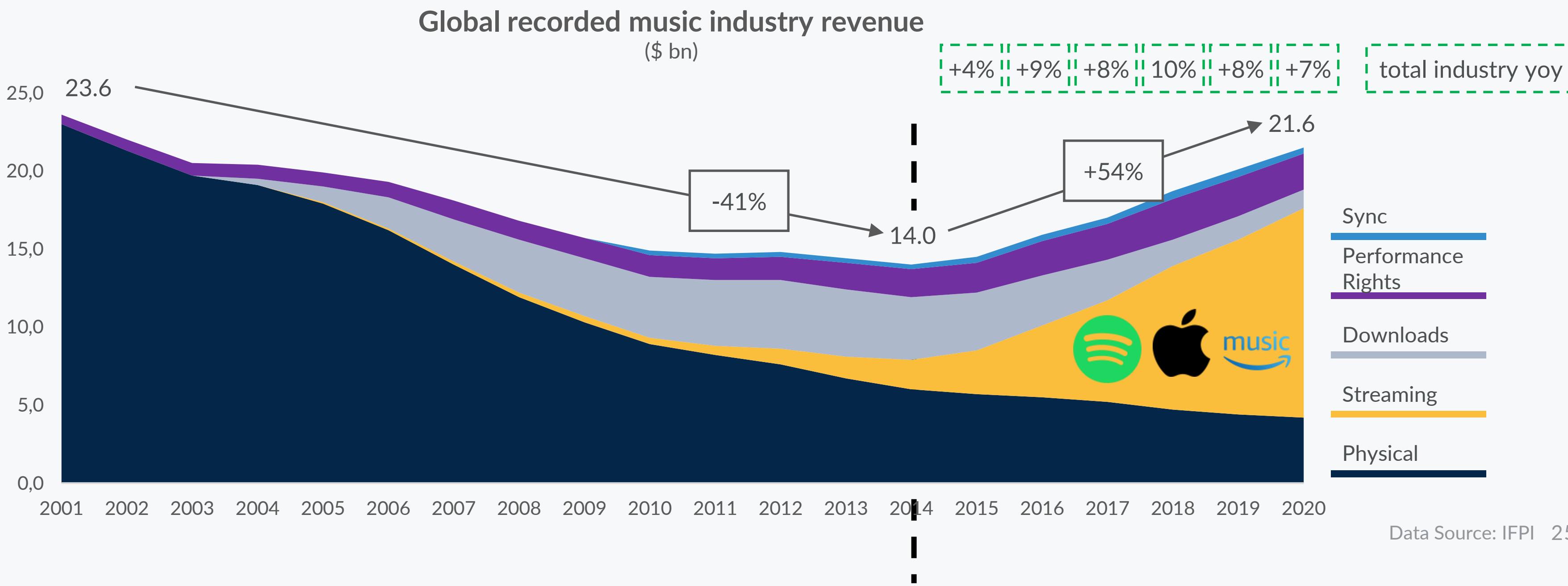
PRE STREAMING, PIRACY WAS CRUSHING THE LABELS

- Few things are more heavily related to the collapse of music sales than the file sharing service ***Napster***
- Founded in 1999, **Napster popularized illegal mp3 downloads** and even though the service was shut down due to injunction in 2001, piracy was out of the bottle and many alternatives emerged (Kazaa, eMule)



HOW DO YOU STEAL FROM PIRATES? PART I

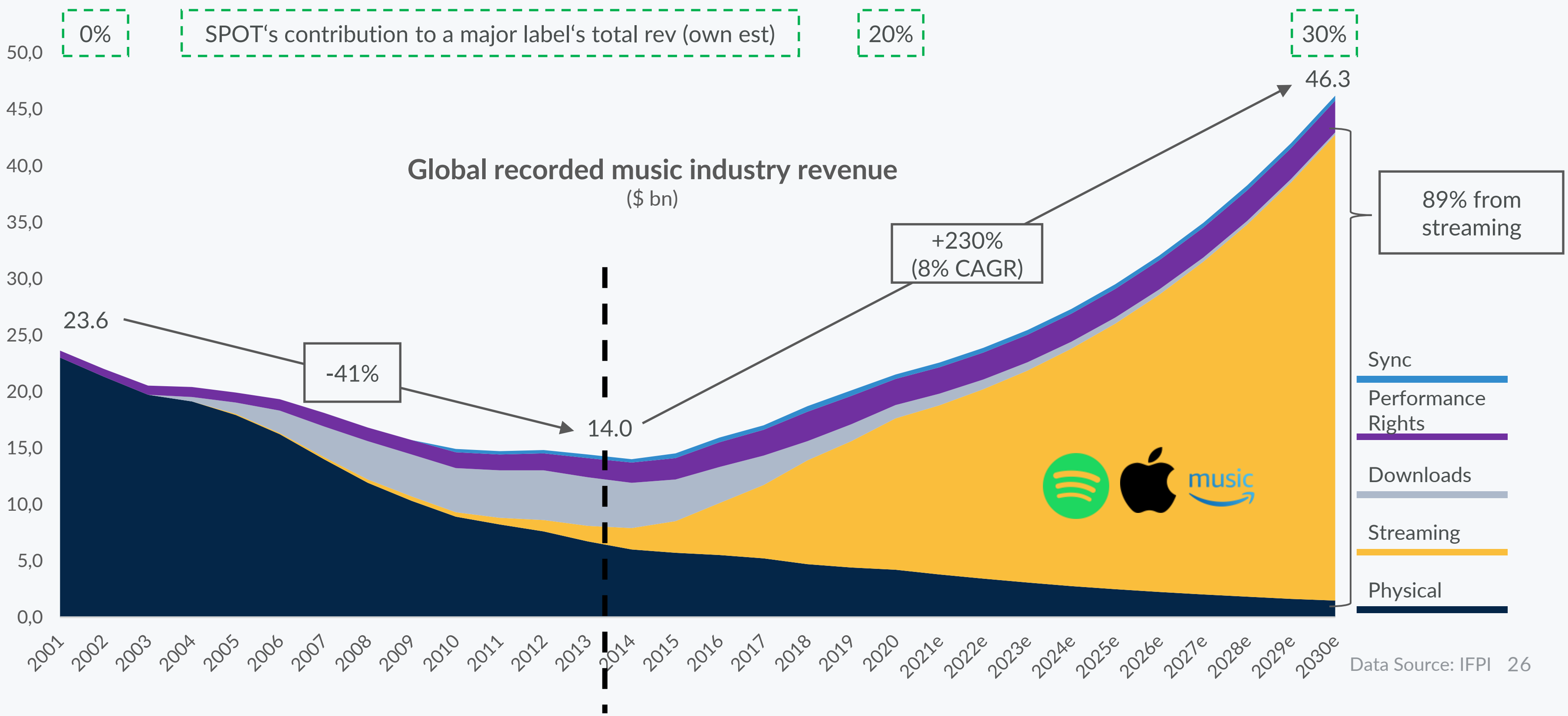
- Global recorded music industry **revenue tanked -41% from $23.6 to $14.0 bn in 2014 due to piracy**
- SPOT launched its streaming service 2008 in Europe. The idea of having the **world's entire music catalogue in your pocket for $9.99/month revived a dying industry** and helped the industry grow HSD again



Data Source: IFPI

HOW DO YOU STEAL FROM PIRATES? PART II

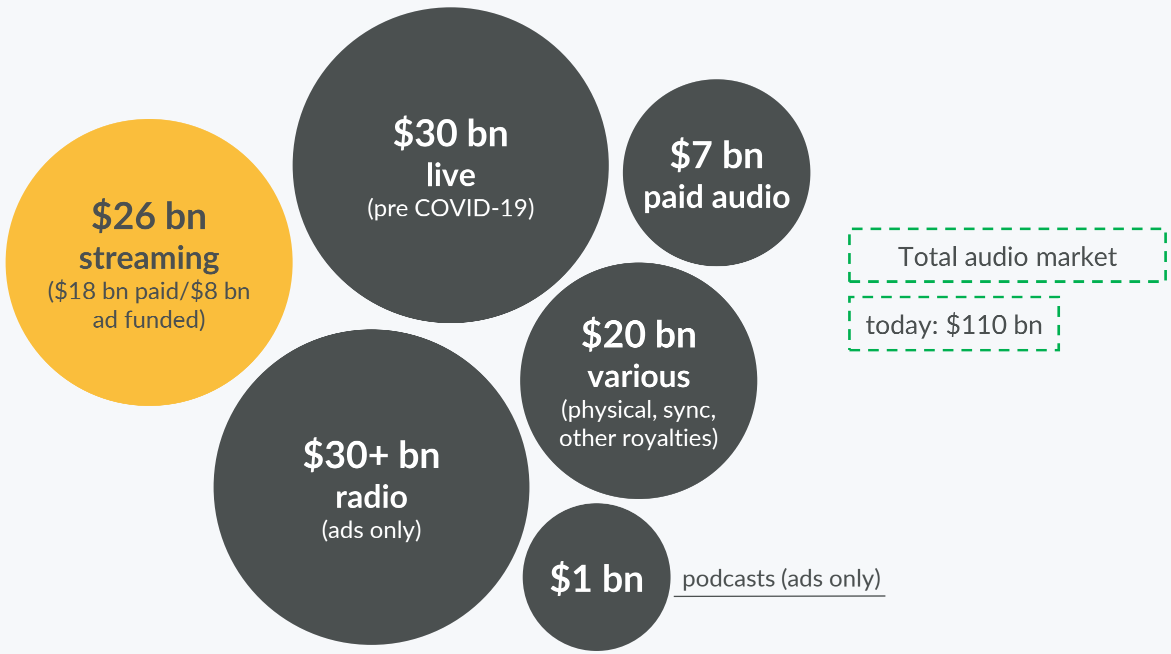
- 2030e 89% of the recorded music industry will come from streaming (62% today), SPOT can be 35% of that



Data Source: IFPI

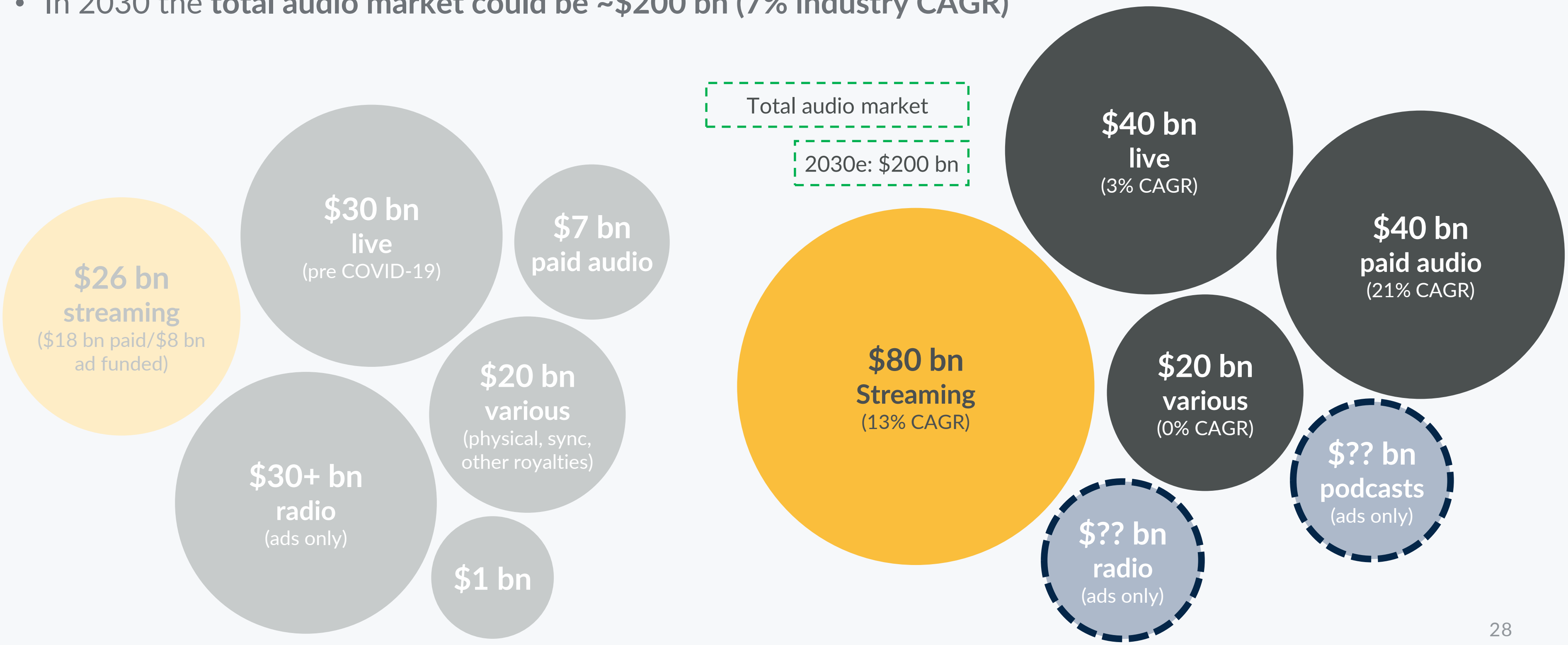
FROM A DYING INDUSTRY TO A THRIVING INDUSTRY

- Music streaming (paid and ad supported) is a $26 bn industry today (gross), 2/3 go to labels/publishers. Label's streaming gross share of $13 bn (~55%) equals 62% of the total recorded music industry ($21.6 bn)
- If one includes live concerts, various royalties from sync, radio and other performance rights as well as the global radio ad market, **the total audio TAM today represents a $110+ bn opportunity**



GLOBAL AUDIO ON TRACK TO A $200 BN OPPORTUNITY

- I expect music streaming (paid and ad supported) to be a ~$80 bn industry (gross) in 2030 and **the gross label share of ~55% ($44 bn) to account for 89% for the entire recorded music industry in 2030**
- In 2030 the **total audio market could be ~$200 bn (7% industry CAGR)**



COMPANY BACKGROUND

A SHORT HISTORY OF HOW SPOT GOT HERE

- **Spotify was founded in 2006 by swedish tech entrepreneur Daniel Ek together with Martin Lorentzon**. Ek – at this point 23 years old – sold his adtech company Advertigo to Lorentzon's affiliate marketing network Tradedoubler shortly before for $2m. Lorentzon netted himself more than $20m from Tradedoubler's IPO

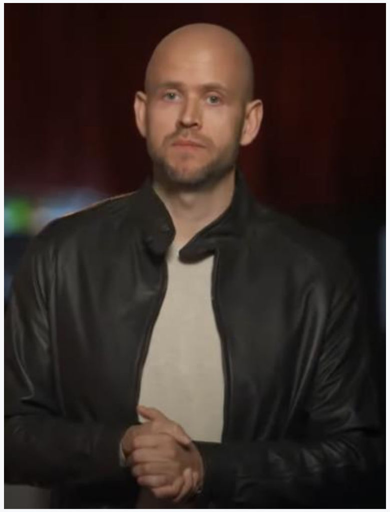
- Ek originally grew up in a rough neighborhood 30km south of Stockholm, his mother worked as a childminder, his stepfather eventually landed a job in IT. Ek received a guitar and a C64 at a young age. **He taught himself how to code but also how to play the guitar, drums and piano**. For a long time, Ek thought he'd be a professional musician but in his teenage years he shifted his focus to technology. **At Age 14 he and some friends started building websites for local businesses (Ek netted himself $5-15k per month)**. At Age 16 he applied for an engineering job at Google (which he didn't get) and after high school he studied computer science in Stockholm (until he dropped out because he didn't like theoretical math)

- Later in life the somewhat geeky and formerly overweight Ek spent his money from the Advertigo exit on a luxury apartment in Stockholm, a Ferrari and buying champagne to impress women in nightclubs (*"I really thought I wanted to be a much cooler guy than I was."*). **He quickly fell into a quarter-life depression, left Stockholm and moved into a small cabin in the woods** where he played the guitar and meditated.* Around the same time, he started bonding with Lorentzon and the two decided to start a new company together

- For their new venture, **Ek decided to leverage two of his personal competencies and passions (technology and music)** and Lorentzon provided the seed funding of $2m. While Ek initially thought it would take three months to license the music rights from labels for Europe it took two years until SPOT launched in 2008

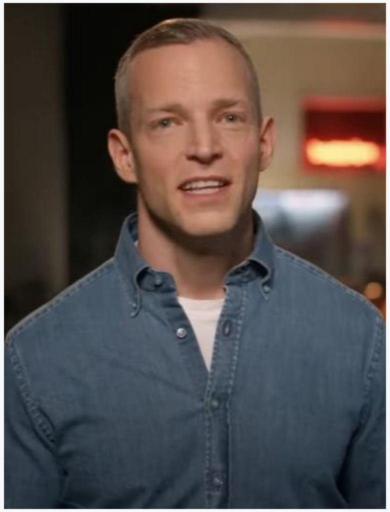
*this whole „party boy –> depression"-episode told by Daniel Ek should be taken with a grain of salt, as he used to have a reputation to spice up his stories

KEY PEOPLE YOU SHOULD KNOW AT THE COMPANY



DANIEL EK
CEO & Founder, owns 8.1%

Age 38, can be CEO for next decade+, key person behind SPOT's strategy, **brings clear sense of purpose into SPOT**, agile development culture, projects may fail, humble man, lifelong learner, tries to learn 3-5 new mental models per year, prioritization of tasks and improved decision-making top of mind for Ek



GUSTAV SÖDERSTRÖM
Chief Research & Development Officer

Age 43, founded Kenet Works, sold it to Yahoo, oversees the product, design, data, and engineering teams at SPOT (3k out of 6k total employees), leads UX and ML strategy, key person behind **executing Ek's vision into the final product**, algotorial improvements are highly relevant for user engagement

DAWN OSTROFF
Chief Content & Advertising Business Officer

Age 61, former broadcast network executive, oversees SPOT's original content initiatives in podcasts, leads global advertising sales; in short, Ostroff is **responsible for all major margin levers SPOT is trying to pull in podcasts/ads** over medium term, highest base salary ($1m), signing bonus of $2m

MARTIN LORENTZON
Director & Founder, owns 11.1%

Age 52, essentially **the money guy**, secured SPOT's initial financing rounds, rich through IPO of Tradedoubler, silicon valley veteran (worked for search engine Alta Vista in the 90s), stepped down as chairman of SPOT's board in 2016, today no longer involved in day-to-day operations as far as I know

Image Source: Spotify

STRENGTHS IN THE COMPANY’S CULTURE

NEWSWEEK MAGAZINE

Spotify Is America's Most Loved Workplace

BY PETER CARBONARA ON 10/22/21 AT 5:00 AM EDT

- SPOT scores high in employee satisfaction and has always leveraged an **engineering driven culture with thousands of tests and experiments**. Each year the c-suite updates a so called **“bets board” where resources are allocated to the top bet first, the second bet afterwards, and so on**. The top bet should never fail and six should fail before five. 2014 the top bet was the new ad tier and 2019 the top bet was the move into podcasts. Daniel Ek is responsible for setting the top bets which he then delegates to local leadership teams

- *“Over the last 2 years, we have tripled the number of experiments from a few hundred to thousands of A/B tests. Some of these experiments yield nothing more than a few key learnings, while others have shown great promise. In one of our recent podcast experiments, we increased listening among the test group by 33%. And that's just one example of many. And when we see results like this, you should expect us to invest even more. And we know that* ***no one experiment is going to materially impact us even in the next year. It's the thousands of little things that we're doing which will gradually add up over time.****”* – Daniel Ek, Q2/20 Earnings Call

- *“So why does this velocity matter so much for Spotify? Well, I believe that it will ultimately determine our long-term success. If you're slow, you better be right most of the time. But* ***if you're fast, you can test and iterate more, which creates a culture of innovation. And at Spotify, we want to constantly iterate and improve****. And there's no question that we will always have competitors. And some of them will be good, but I believe we will be better, because we're focused on our stakeholders, the creators and consumers and we prioritize speed and we adapt quickly. So by constantly improving our user experience, user will not only come to Spotify, but we will retain them. And if we retain our users, we will bring more creators to the platform to share their content. Better content means more advertisers. And all of these things coupled together, users, creators and advertisers, unlock the power of our flywheel.”* – Daniel Ek, Q3/21 Earnings Call

Image Source: Newsweek

MUSIC ROYALTIES 101

CORE INTELLECTUAL PROPERTY RIGHTS IN MUSIC

The music industry knows two separate core intellectual property rights: the *song* vs. the *sound recording*.

- The ***song* (lyrics, notes and composition)** is generally controlled by publishers whereas the ***sound recording* (final master recording that gets distributed physically as CDs or audio files)** is generally controlled by labels
- Whenever music is played or streamed, different copyrights and controls are being exploited and **rightsholders are entitled to receive royalties.** There are lots of intricacies how music rights are being licensed and who collects the money
- Four interesting findings are: 1.) in **live music labels don't have to be paid** (the song is used, the master recording isn't), 2.) rights owners are often obliged to license radio stations (which hinders exclusivity in streaming), 3.) due to **antiquated law US radio stations only pay for the song rights** (no income for labels/artists) and 4.) artists make the majority of their income from live touring

You burn a copy of a track onto CD

You are exploiting the 'reproduction control'
of both the song and recording copyright
(what music publishers call the 'mechanical right')

You perform a song at a gig

You are exploiting the 'public performance control'
of just the song copyright

You play a track on the radio

You are exploiting the 'communication control'
of both the song and recording copyright

You synchronise a track to a TV show

You are exploiting the 'reproduction control'
of both the song and recording copyright
when you actually synchronise the track...

and then the 'communication control' of both the song
and recording copyright when the TV show is broadcast

You download or stream a track

You are exploiting both the 'reproduction control'
and the 'communication control'*
(probably the specific 'making available control')
of both the song and recording copyright

Source: The Music Managers Forum and CMU Insights

THE JOB OF PUBLISHERS VS. MUSIC LABELS: PART I

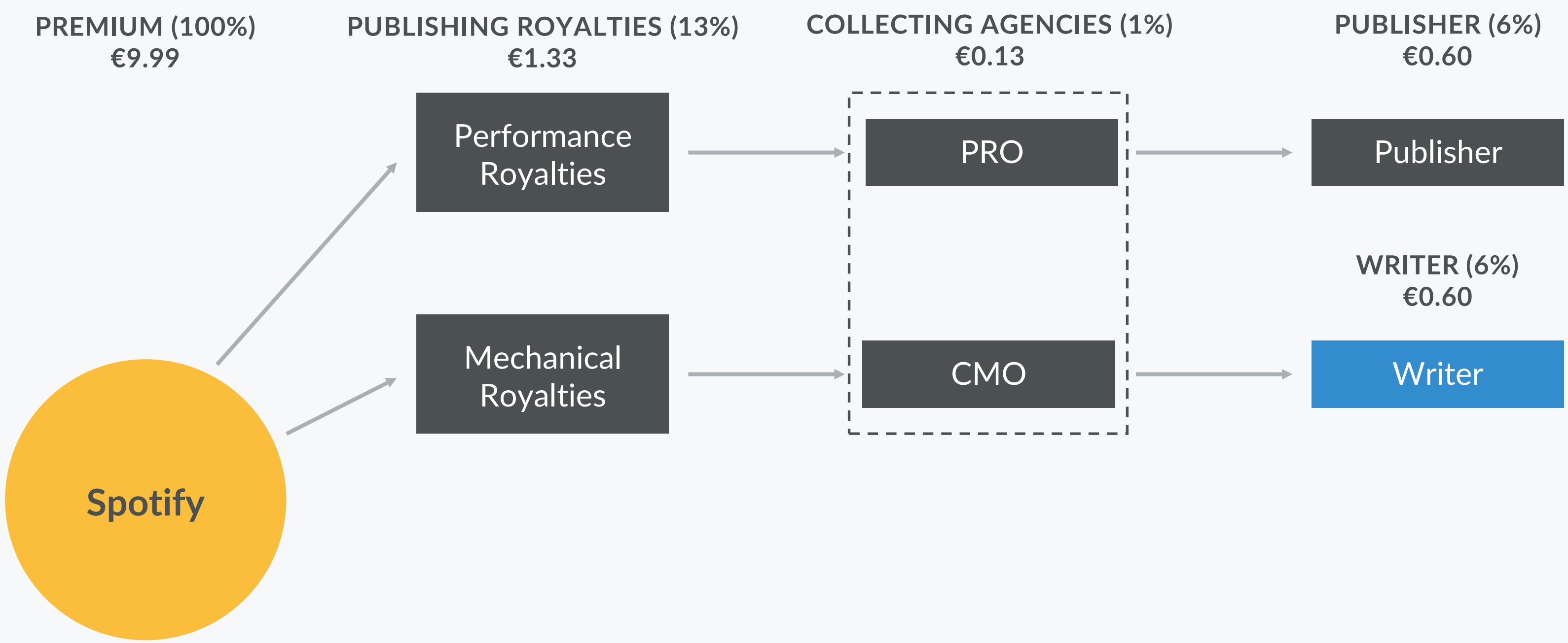
Music publishing ($6.0 bn) is a fraction of the $21.6 bn recorded music industry (labels). Mostly because producing/studio time/equipment has more costs and value than writing a song on a piece of paper.

- ***Publishers*** work with songwriters and pitch songs to their network of artists. Once an idea was turned into a master recording, each time the song is reproduced (streaming, iTunes, CDs) or publicly performed* (streaming, radio, in-store, live concerts), mechanical or performance royalties are earned by the publisher
- Songwriters need to register their songs with a Performing Rights Organization (PRO) or Collective Management Organization (CMO). These societies track and collect the performance royalties due to songwriters and music publishers. Mechanical royalties are collected by a CMO or Mechanical Rights Organizations (MRO)
- The **payout of all music publishing revenue is typically 50:50 between the songwriter and publisher** (after a 10% cut for the collecting agencies)
- The **global music publishing industry had revenues of $6.0 bn in 2020** vs. $21.6 bn for recorded music
    - thereof: ~40% performance royalties/30% mechanical royalties/30% sync royalties and other
    - thereof: ~30% from streaming

*the industry parlance here is somewhat dated, e.g. streaming to your headphones would trigger "public performance" royalties

HOW IMPORTANT IS STREAMING FOR PUBLISHERS?

From all streaming revenues (100%), publishers typically take home 6%, writers 6% and collecting agencies 1%. In total, streaming accounts for ~30% of all publishing revenue vs. 62% of all recorded music revenue.



THE JOB OF PUBLISHERS VS. MUSIC LABELS: PART II

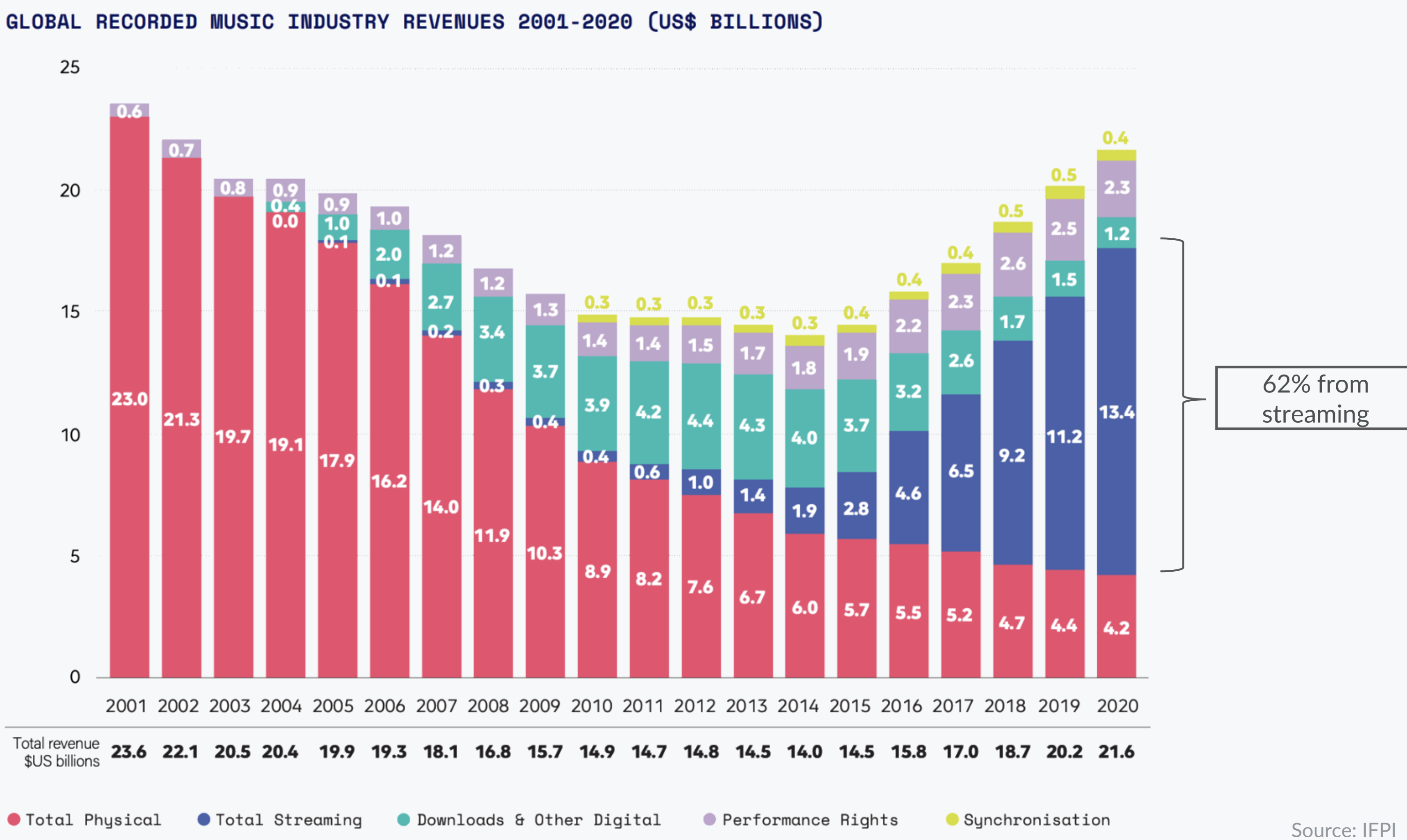
Recorded music ($21.6 bn) is a much larger industry than publishing at $6.0 bn. Labels receive ~55% of all DSPs' streaming revenue vs only 10-15% for publishers, so the labels' fate depends more directly on SPOT.

- ***Labels*** sign upcoming artists and pay them cash advances for exclusive ownership of the artists' future master recordings (**they effectively act as VCs funding many risky projects with unknown hit/CF potential**)
- *Labels* administer the production of an album and handle the marketing, monetization and distribution of it
- The earnings (above advances) from releases are **often shared 85:15/80:20 between the label and the artist**
- Most signed artists are not commercially successful, which leads to the situation (again: as in VC) that **a few stars will overcompensate for all loss-makers** and stars will naturally think their early contracts were unfair
- Independent artists own their masters, produce and promote their work themselves (via social media) but still rely on 3rd party distributors like *Kobalt* for access to all DSPs and monetization (i. e. royalty collection)
- In contrast to music publishing the *labels* bundle mechanical and performance rights into one directly negotiated license and collect royalties via distributors (the latter are sometimes insourced)
- All **major streaming DSPs are licensed by major labels on a rev share basis!**

it's important to know that labels and publishers can sometimes operate under the same corporate roof, e. g. UMG is the #1 label (32% ms) and #2 publisher (23% ms)

HOW IMPORTANT IS STREAMING FOR LABELS?

Streaming accounts for 62% of all recorded music revenue vs. ~30% for the music publishing industry. 19% of recorded music revenue still comes from physical sales and 6% from downloads (based on IFPI data).

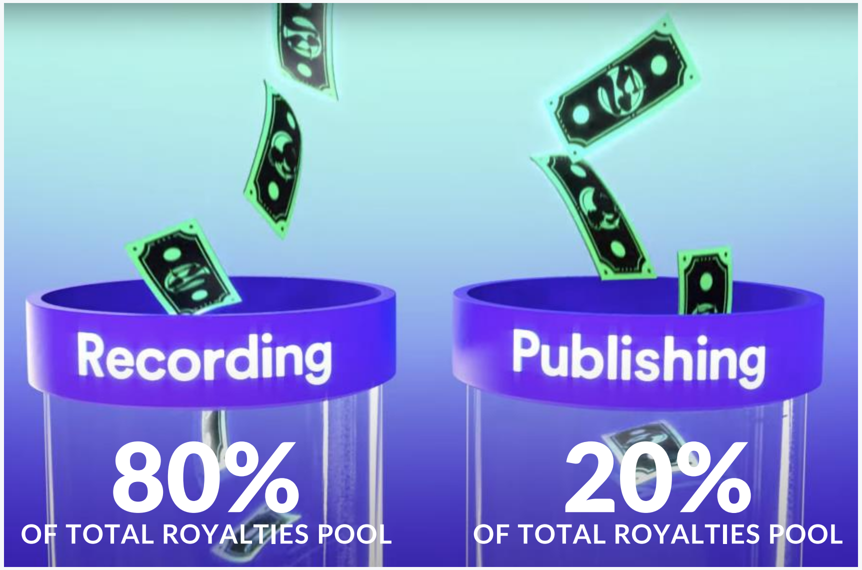


Source: IFPI

HOW DOES SPOT DEAL WITH PUBLISHERS AND LABELS?

SPOT's deals with publishers and labels based on revenue share arrangements sometimes coupled with fixed minimum guarantees per user (e. g. when entering a new emerging market with low ARPU).

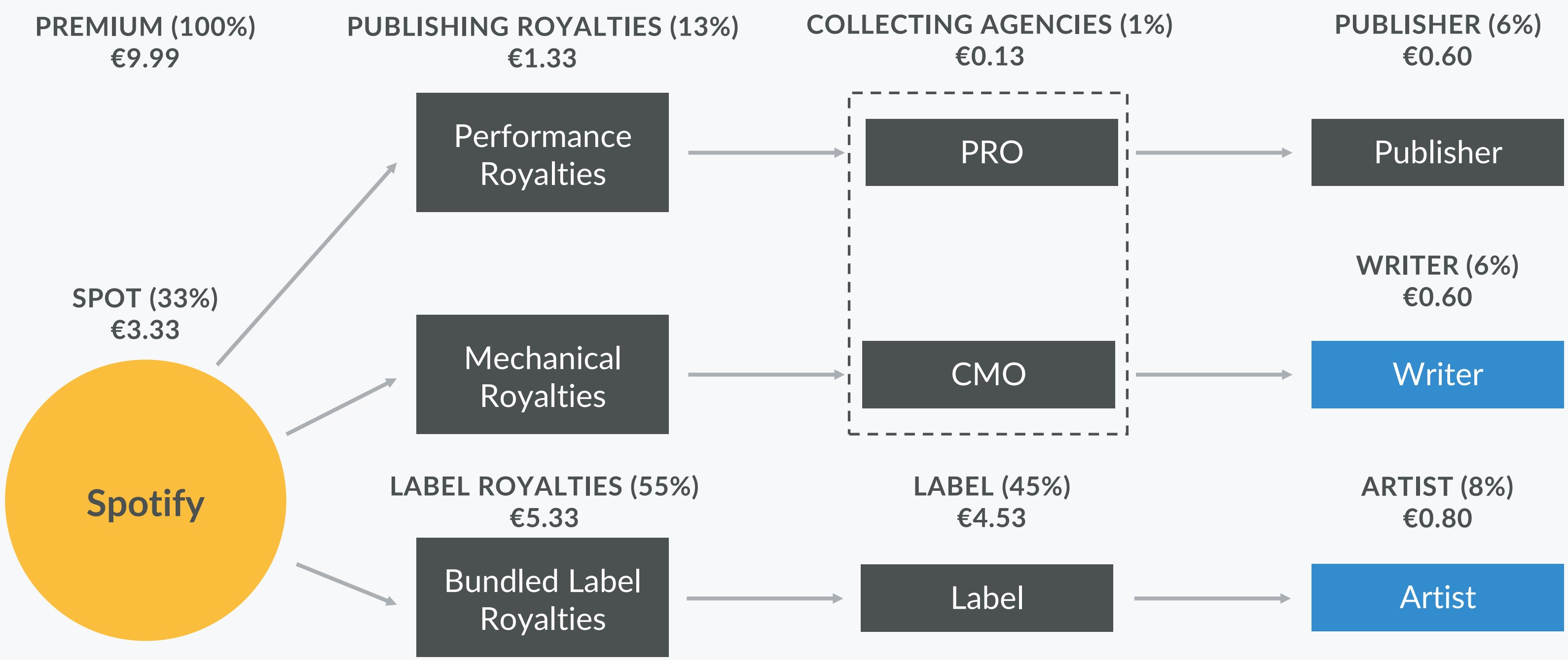
- SPOT's rightsholder payouts follow this scheme:
  - A **total royalties pool is defined as 2/3 of net revenue** from all premium subscription revenue plus all music advertising revenue
  - **80% of the total royalties pool gets allocated to the recording rights bucket (labels),** 20% to the publishing rights bucket
  - In simpler terms: **labels collect ~55%* of SPOTs total revenue, publishers 10-15%**
  - **SPOT pays individual rightsholders monthly on the basis of streamshare** (defined as the rightsholder's # of streams/all streams)
- Often misunderstood: **SPOT does *not* pay artists directly!** (however, they do pay O&E podcasters)



*the 55% for labels and 10-15% for publishers is *before* payouts to artists and songwriters (**gross**); the **net** label/publisher shares are lower; Image Source: Spotify

SO WHERE DOES THE $9.99/MONTH FINALLY END UP?

From all streaming revenues (100%), labels take home the lion's share of 45% (net), artists 8%, publishers 6% (net), writers 6%, collecting agencies 1% and SPOT keeps 33% (before other COGS and OPEX).



Indie artists without a label contract could make up to 3-4x the money, but need to pay for marketing and production themselves

WHO DOMINATES STREAMSHARE AT SPOT AND AAPL?

Among the most popular artists in streaming and album sales, UMG represents 9 out of the top-10. Since labels act similar to VCs, most new upcoming stars want to work with the historic most prestigious player.

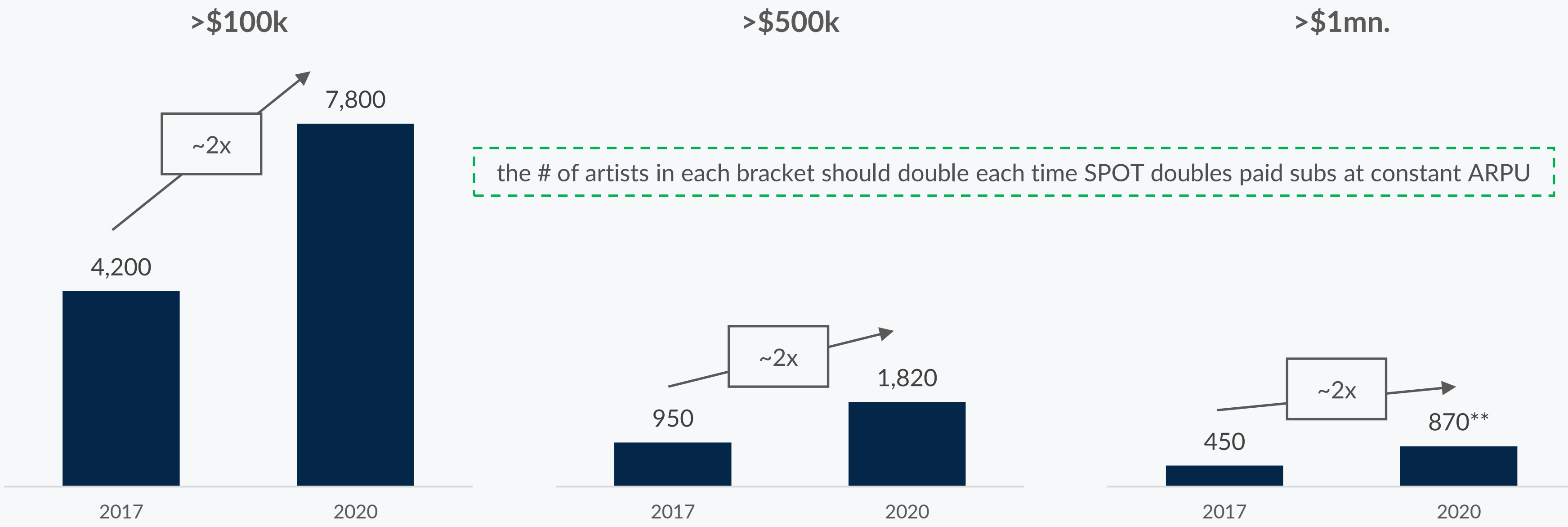
- BTS: Big Hit Music
- Taylor Swift: UMG
- Drake: OVO (UMG)
- The Weeknd: XO (UMG)
- Billie Eilish: Interscope (UMG)
- Eminem: Shady (UMG)
- Post Malone: Republic (UMG)
- Ariana Grande: Republic (UMG)
- Juice Wrld: Interscope (UMG)
- Justin Bieber: Def Jam, RBMG (UMG)

Image Source: IFPI

HOW MANY ARTISTS MAKE SERIOUS $$$ FROM SPOT?

In FY20 SPOT paid out $5+ bn to rightsholders. A particular rightsholder is remunerated based on stream-share (there are NO per-play/per-stream rates!). Roughly 2k artists made $500k* in gross-royalties in FY20

OF ARTISTS WHOSE CATALOGS GENERATED RECORDING AND PUBLISHING ROYALTIES OF:



*gross royalties are shared between the label, publisher and artist. A (non-indie) artist with $500k in royalties could net $70-100K, so not many artists today can live from streaming alone

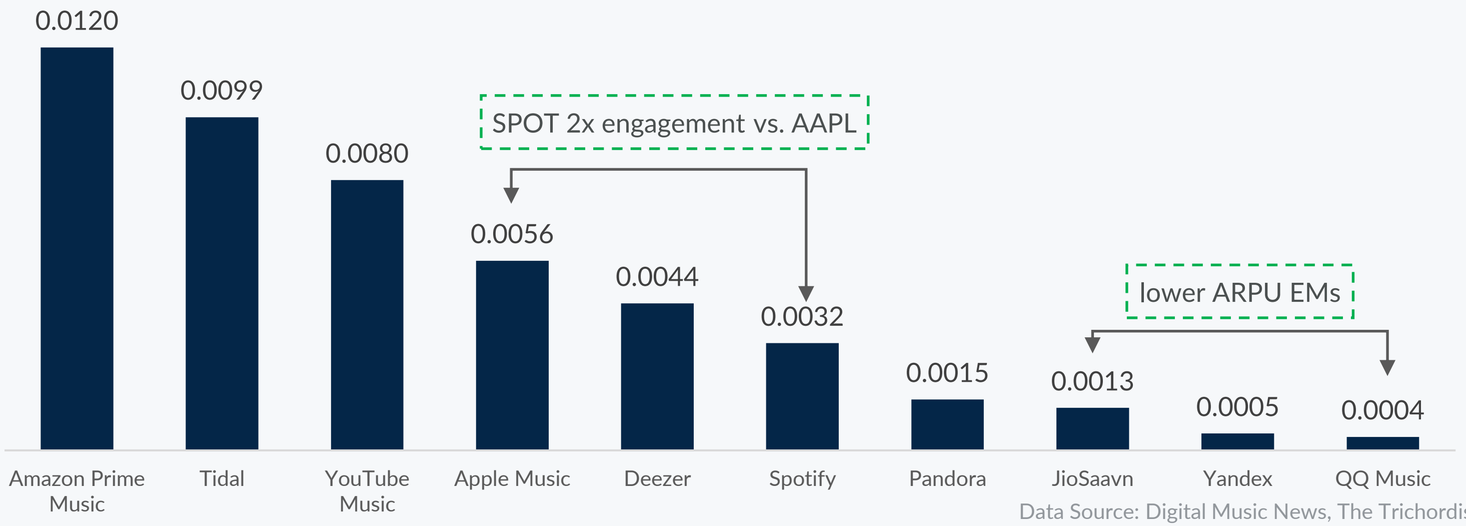
the top-500 artists on SPOT generated **average gross royalties of $3.7m in 2020 and had an average of 17.3m monthly listeners

PER-PLAY/-STREAM RATES DON'T EXIST OR MATTER!

This is important: Often there are NO predetermined per stream rates! DSP rates portrayed in the media are reverse calculations of actual payouts/total streams. They are meaningless for a number of reasons.

- Imagine SPOT doubles paid subs (then the royalty payout pool also doubles for the sake of a healthier music industry) **but if user engagement doubles as well, reverse calculated per stream rates would fall by 50%**
- A standard SPOT plan in Germany is €9.99/month vs. €1.50/month in India, **entering new lower ARPU markets lowers implied per stream rates** (gross margins however stay the same for SPOT due to rev share)
- In comparison to AAPL, **SPOT's implied per stream rates must be lower due to the ad-supported tier**

REVERSE CALCULATED PER-STREAM RATES BY DSP IN $



Data Source: Digital Music News, The Trichordist, Soundcharts

A PIVOT IN STRATEGY: AUDIO > MUSIC

THE GROSS MARGIN PROBLEM IN SPOT’S CORE BIZ

- Initially market participants framed SPOT as the “Netflix for music”. **Soon it became evident that NFLX’s cost structure in video is much more favorable than SPOT’s in music.** NFLX pays fixed amounts for licensed or self-produced content and these costs do *not* grow in line with incremental revenues, whereas SPOT’s costs to music rightsholders rise in tandem with incremental revenue (which puts a cap on gross margins)
- SPOT’s management team realized they need a business model besides music with more fixed costs. **In a famous blog post (Feb 19) Daniel Ek declared that all audio — not just music — will be the future of SPOT**
- The **#1 new bet of SPOT’s audio-first strategy is reaching the #1 position in podcast consumption** (and afterwards probably try to conquer audiobooks, meditation, live audio chatting etc.). In FY20 **25% of SPOT’s MAUs listened to podcasts and >20% of total content hours consumed should be non-music long-term**
- ~3 years into the strategy, **SPOT reached the #1 position in podcast consumption in 60+ countries and recently overtook Apple Podcasts as #1 in the US** (the largest podcasting market). During the latest label renegotiations SPOT successfully carved out all podcast advertising revenue from the music royalties pool
- **SPOT recognizes all revenue from podcasts and content costs in the ad-funded segment, which still results in a drag on gross margins** (e. g. in FY20 SPOT recorded incremental podcast COGS of $63m vs. $27m incremental revenue from podcasts). Note that SPOT will serve podcast ads to free as well as premium users
- While music supply is highly concentrated (4 big labels), **podcast supply is more fragmented and lower cost**

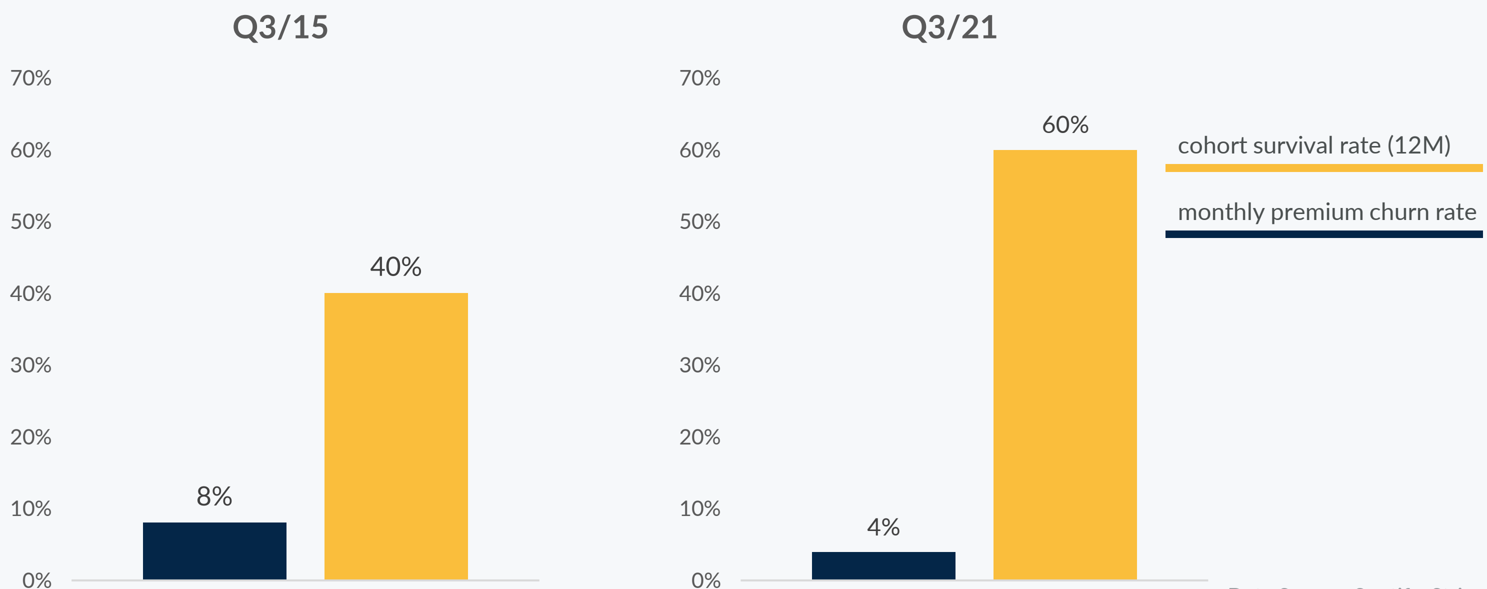
IN MUSIC, LTV/CAC IS POSITIVE BUT NOT EXCELLENT

- With a software subscription model – assuming a large enough market – **companies can ignore all costs that don't grow in line with the total number of customers *as long as* LTV/CAC ratios are excellent**
- SPOT defines lifetime value of its premium subcribers as: $\boldsymbol{LTV = \frac{1}{churn} x\ ARPU\ x\ gross\ margin}$
- In Q3/21 SPOT's premium churn was 3.9%, ARPU was $4.34 and premium gross margin was 29.1%, which puts **LTV at $32.38. SPOT internally sees a LTV/CAC ratio of ~2.7x which implies CAC of $12.00**
- My own calculation is different (for instance I take into account the time value of money), but the math isn't precise (lacking data points are: how much S&M goes into customer acquisition, ad user churn and gross to net additions). I see a **blended LTV per MAU gross add of $16 against $9 CAC for a LTV/CAC ratio of 1.7x**
- Improvements in subscriber economics will be multiplicative *not* additive (**e. g. a 50% improvement in SPOT's churn and 50% higher ARPU would increase subscriber economics by 125%** not just by 100% and increase the entire EV of the company *not* just the value of the freshest cohort)

Data Source: Spotify

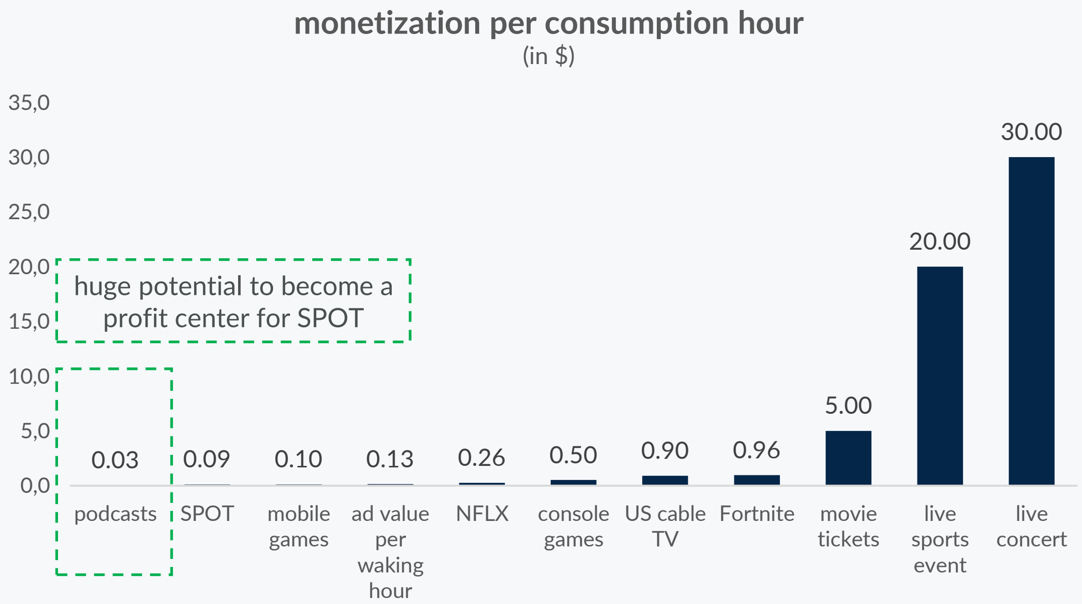
MUSIC CHURN RATES STEADILY IMPROVED FY15-21

- **SPOT increased its music LTV significantly by decreasing premium churn from 8 to 4%**, today's major component of churn is payment failure (1/3 of churn), win back rate is 70% of churned subs over next 3M
- In consumer internet, **churn rates of 2% are world-class, 5% are fine, 7% means room for improvement** and 10% usually means you're going out of business



HOW COULD PODCASTS LEAD SPOT TO PROFITABILITY?

Podcasts could solve the music margin problem! *Every time* a medium emerges which captures lots of user time, monetization will follow. Podcast engagement is high, monetization at $0.03/hour still in its infancy.

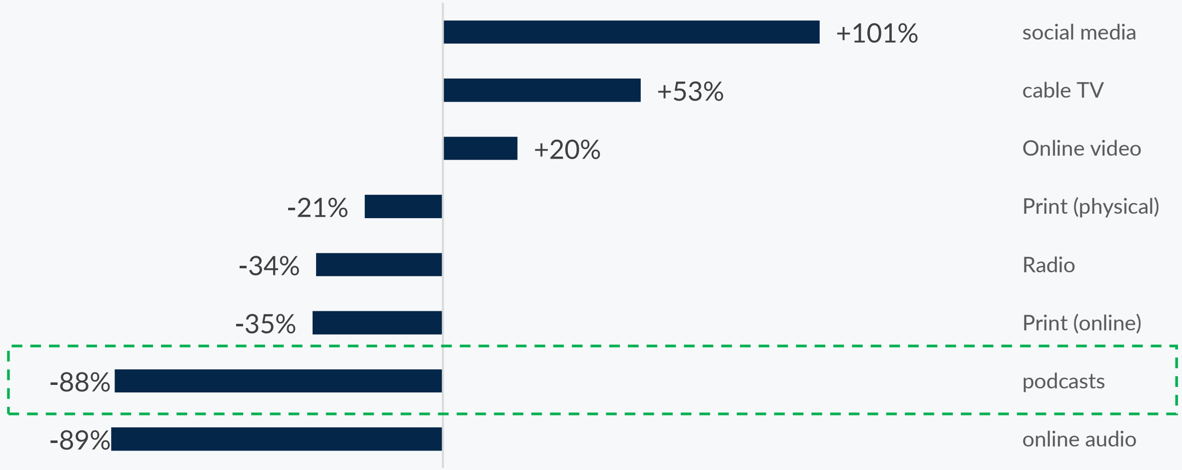


Data Source: own estimates

PODCASTS ARE 10X UNDERPRICED VS. TIME SPENT

One would rightfully assume social media gets more ad dollars vs. time spent (targeting, CTAs, attribution), linear radio less (low capabilities). Dynamic podcast ad spend should approach time spent over time (>10x).

US advertising spend vs. time spent between different media
(in %)



WHY ARE PODCAST ADS SO UNDERDEVELOPED?

- A brief history on podcast ads: **Apple launched Apple Podcasts in 2012. The company's main rationale for the software release was to sell more devices (iPods, iPhones)**, not to become a profit center itself
- The podcast industry works in a way that a **podcatcher app like Apple Podcasts doesn't actually host or own the podcast audio files**. Instead, files are decentrally stored and delivered to a user's podcatcher based on the open RSS standard. **Apple Podcasts/Overcast/Pocket Casts serve as a user's directory for RSS feeds and new episodes are downloaded upon the user's request**
- ~25% of the US population listens to a podcast weekly, often for ~7 hours/week (mostly while commuting)
- The **entire US podcast ad industry was worth a miniscule $300m in 2017, $1 bn in 2020 and should hit $2.2 bn by 2023** (growing at 30%+), **which means podcast monetization per consumption hour is extremely low at 3-4 cents/hour** (compared to 13 cents advertisers pay for every waking hour per US person on avg.)
- Even the radio ad market is **worth north of $30 bn (18+ bn in the US) and this is an underdeveloped, non-interactive ad market** lacking relevant internet-level measurement/targeting/conversion capabilities
- The open nature of podcasting (RSS) means no central aggregator owns the entire ad tech stack. Given the small TAM and due to Apple's privacy policy, Apple Podcasts never built an ad centric business around podcasts. However, **the industry absolutely needs a way to make money besides paid subscriptions/host read ads. SPOT will lead this revolution,** AMZN may become a strong #2 (with the help of Art19/Wondery)

SMALL PODCASTERS CAN'T GET DIRECT AD DEALS

Host read ads (CPM $20-50) are the bread and butter of podcast advertising. The problem is, only big stars can play. 99% of podcasts have <4k listeners/episode, these can't market their shows, but their audience.

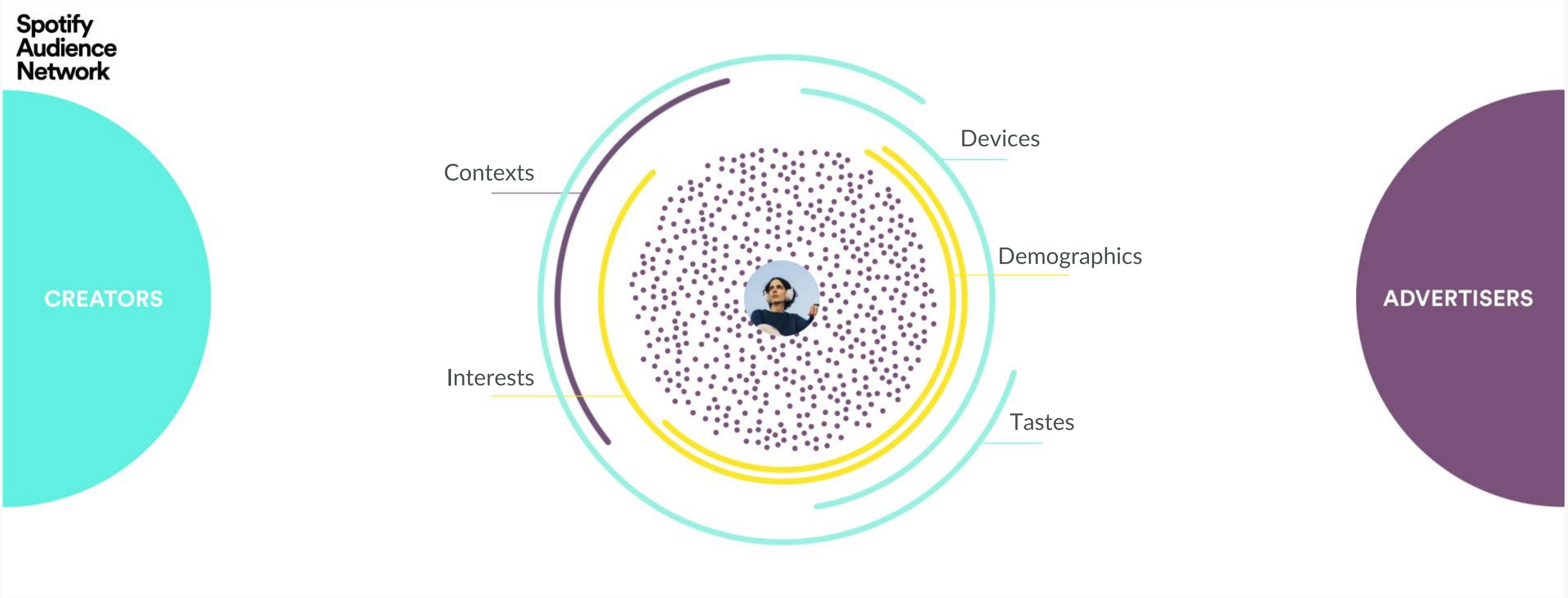


Image Source: Spotify Audience Network

HOW SPOT IS TRYING TO IMPROVE THE AD ECOSYSTEM

There are many podcast ad companies, but only SPOT has creators, advertisers, listeners all on the same platform. SPOT is trying to unify the entire podcast tech stack and bundle small audiences for advertisers.

"MONETIZING PODCAST AUDIO CONTENT IS SOMEWHAT DIFFERENT, CERTAINLY HOW IT WORKS TODAY BUT ALSO WHERE WE WANT TO BRING THE INDUSTRY TO. SO WE'RE DEVELOPING A LOT OF THOSE TOOLS. SOME OF THEM YOU'VE HEARD US TALKING ABOUT, LIKE THE SAI INSERTS, WHICH IS STREAMING AD INSERTION. AND WE'RE STILL EARLY DAYS IN TERMS OF THE DEVELOPMENT OF THOSE AND TRIALING OF THOSE. BUT FOR US, WHEN WE LOOK AT THE OVERALL OPPORTUNITY, IT IS PRETTY CLEAR THAT WE DON'T – WE HAVEN'T ADDED INTERNET-LEVEL MONETIZATION YET TO AUDIO. SO ALL THE THINGS THAT YOU'VE COME TO EXPECT IN VIDEO AND DISPLAY IN TERMS OF MEASURABILITY, IN TERMS OF JUST TARGETING, A LOT OF THAT IS LACKING IN PODCASTS TODAY. AND YOU'VE SEEN IT TIME AND TIME AGAIN, AS YOU ADD THOSE CAPABILITIES, YOU GENERALLY CAN RAISE CPMS ACROSS THE BOARD BECAUSE ADVERTISERS FEEL MORE CERTAIN ABOUT THE RESULTS THAT THEY'RE GETTING. AND IF WE DO THAT, THAT'S GOING TO BE A TREMENDOUS BENEFIT FOR ALL THE PODCASTING CREATORS, BUT IT'S ALSO GOING TO BE A TREMENDOUS BENEFIT FOR SPOTIFY."

- DANIEL EK, Q4/19 EARNINGS CALL

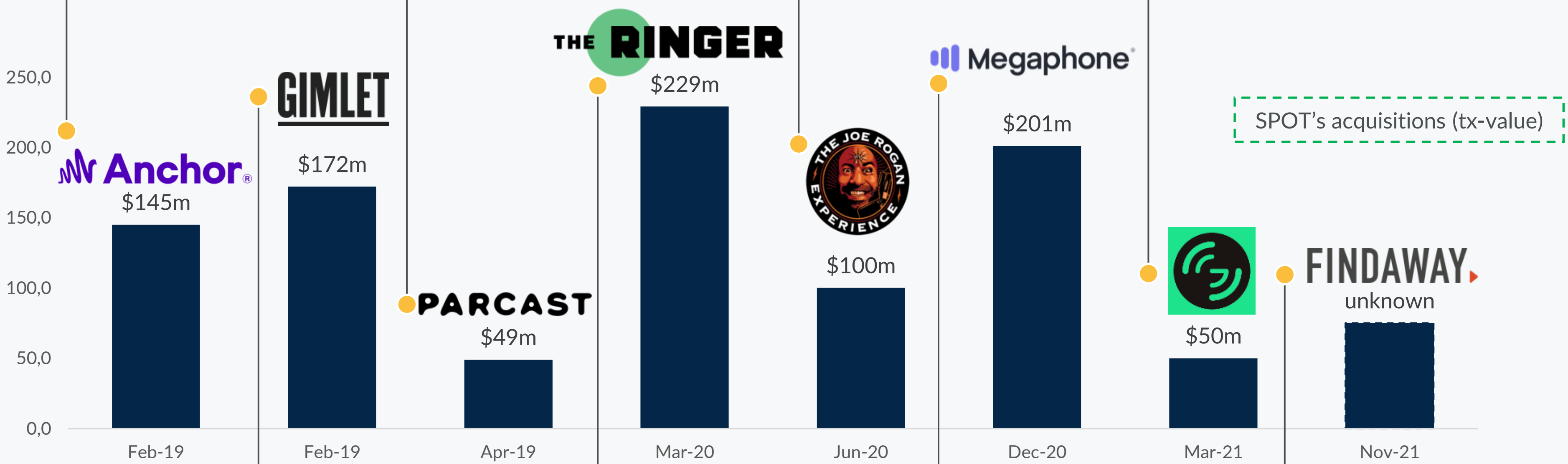
SPOT'S BUILDING BLOCKS FOR SCALING PODCAST ADS

Creator software for recording and distributing a podcast. 50% of podcasts/ 80% of new podcasts on SPOT are hosted by anchor

Podcast content production studio focused on storytelling with series like Serial Killers or Unsolved Murders

Podcast content through exclusive licensing with Joe Rogan, the biggest podcast show globally with guests like Elon Musk (with video)

Live audio chatting focused on sports vertical („Locker Room“) which was turned into Spotify Greenroom, a Clubhouse competitor



Podcast content production studio with shows like Heavyweight, Reply All, Science vs., The Nod or The Habitat

Podcast content production studio focused on sports vertical with The Bill Simmons Podcast or The Ringer NBA Show

Podcast hosting and ad tech platform Megaphone created the Megaphone Targeted Marketplace (MTM) for DAI in podcasts

Audiobook distributor which has also built creator tools over the last years like Findaway Voices (pairing authors with narrators)

Source: company reports

WHAT GOOGLE BUILT FOR SMALL PUBLISHERS…

GOOG with AdSense tackled the following problem: small publishers/bloggers with <4k readers were too small and had no way to directly monetize their self generated content (no access to/scale for advertisers).

- **AdSense aggregated publisher ad inventory and made it possible for advertisers to distribute display ads to thousands of small sites via programmatic buying.** Even better, it was made possible to bid for *each individual user* on a site (audience buying) vs. showing the same ad for the entire viewership (title buying)

FOR THE ADSENSE TECH STACK GOOGLE ACQUIRED DOUBLECLICK IN 2007

Publisher/ Creator

Publisher runs website w self generated content e. g. NYT, FT

Ad Server and other Supply Side Software (SSP)

SSP routes the available display ad inventory to ad exchanges

DoubleClick for Publishers

Ad Exchange

The SSP's ad inventory is auctioned real time to DSP by exchanges

DoubleClick Ad Exchange

Buy Side Software (DSP)

DSPs bid on behalf of the advertiser for ad inventory in real time

Display & Video 360

Google Ads

Advertiser

Advertiser targets a site's individual user (who's tracked through Web)

Reminder: Google paid 2x(!) for Doubleclick than what it paid for YouTube

...SPOT WANTS TO BUILD FOR SMALL PODCASTERS!

SPOT with Spotify Podcast Ads tackles the following problem: small creators with <4k listeners were too small and had no way to directly monetize their self generated content (no access to/scale for advertisers).

- Spotify Podcast Ads aggregate publisher ad inventory (podcast files hosted on Anchor/Megaphone) and **makes it possible for advertisers to distribute audio ads to thousands of small podcasts via programmatic buying**. Even better, with SAI it is made possible to bid for *each individual listener* of a podcast (audience buying) vs. playing the same ad for the entire listenership (title buying)

FOR THE PODCAST AD TECH STACK SPOTIFY ACQUIRED MEGAPHONE IN 2020

Publisher/ Creator	Supply Side Software (SSP)	Ad Network	Buy Side Software (DSP)	Advertiser
Creator with own podcast hosted on e. g. Spreaker, Anchor	*SSP routes the available podcast ad inventory to ad networks*	*SSP's ad inventory can be auctioned real time to DSP*	*DSPs bid on behalf of the advertiser for ad inventory*	*Advertiser targets a pod's individual list-ener (targeting must improve)*
Anchor	Megaphone Streaming Ad Insertion (SAI)	Spotify Audience Network	Spotify Ad Studio	

Only SPOT has creators, advertisers and podcast listeners on one platform at scale

DIFFERENT AD TYPES IN PODCAST ADVERTISING

- The following podcast ad types have evolved, and are distributed as a pre-, mid- or post-roll:
    - **Host-read endorsements**: this is the bread and butter business in podcast marketing. People trust the host and judge their ads as real recommendations (e. g. when Tim Ferriss removed ads from his podcast, people got angry as they saw real value in them)
    - **Mass Produced**: Professionally produced audio ads from companies promoting their product themselves (comparable to radio ad)
- Historically, **many ads have been baked into a podcast audio file and stayed in the episode‘s content forever**

- More recently, many ad tech companies emerged that **„dynamically“ insert audio ads into predefined ad breaks** in podcast files each time the episode is downloaded via RSS (DAI) or streamed via SPOT (SAI)

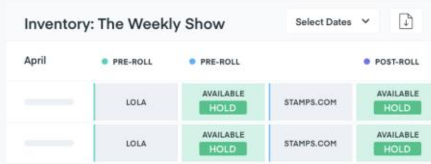
SAI - Streaming Ad Insertion (SAI) is a podcast ad technology available on Spotify that unlocks digital planning, reporting, and measurement for podcast advertisers - based on confirmed ad impressions. Streaming Ad Insertion delivers the intimacy and quality of traditional podcast ads with the precision and transparency of modern day digital marketing.

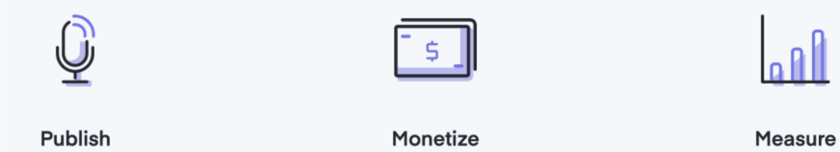
DAI - Dynamic Ad Insertion (DAI) is an ad technology. With DAI, ads are served through an ad server and are inserted upon receipt of a podcast file request. Spotify leverages DAI to serve our ads off-platform on non-Spotify podcast platforms like Apple Podcasts, Overcast, and Stitcher.

Source: Anchor

HOW MEGAPHONE FITS INTO THE BIGGER PICTURE

Megaphone



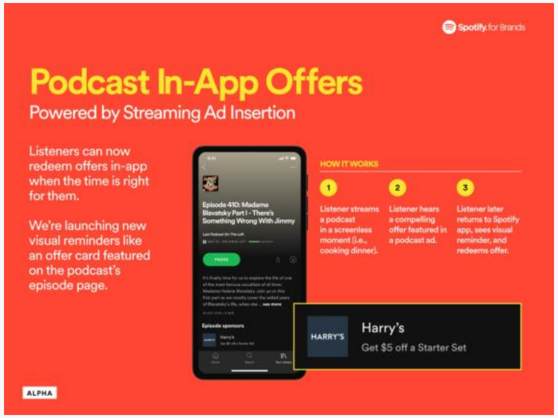


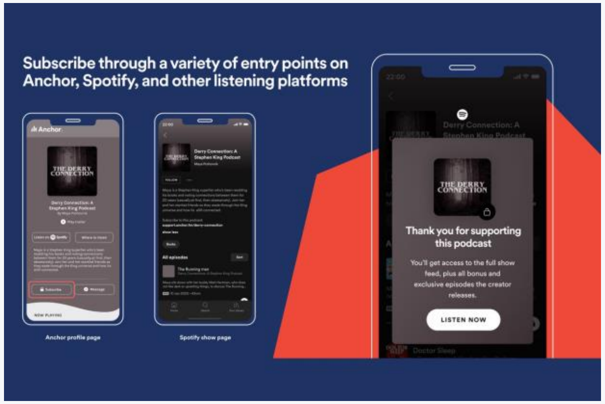
- While podcast apps like **Apple Podcasts collect lots of user data, they DON'T share this data with outside ad networks**. So ad networks like **Midroll** or **RedCircle** **only receive the user's IP address, device type and episode ID** whenever a listener requests an RSS download through a podcast app (limits targeting of DAI)
- Consider in contrast a SPOT O&E podcast streamed through its native app: **in this case SPOT can leverage *all* in-house data it has about a user for ad insertion** (name, age, location, history, interests, friend lists from Facebook etc.) to do a precise targeting of podcast ads to individual users at scale (higher CPMs in SAI)
- In display ads CPMs can drop by 50% if a user cannot be properly identified, therefore SPOT filling podcast **inventory slots inside its native app will be much more valuable to advertisers than traditional DAI**
- Before SPOT acquired **Megaphone**, the podcast hosting and advertising platform pursued a business model similar to Midroll (i. e. **listeners download an identical podcast episode through their favorite app but hear completely different ads dynamically inserted by Megaphone**). It tried to achieve better targeting through an exclusive partnership with Nielsen (i. e. matching IP addresses to Nielsen's demographic segments)
- Inside SPOT Megaphone and Anchor will be moving closer together. They will form a one-stop-shop for creation, hosting and monetizing podcasts. Creators can set predefined time stamps and **Megaphone will fill unfilled inventory leveraging DAI outside SPOT and SAI inside SPOT**. Since many advertisers will want to buy SAI (which will be sold (potentially exclusively) through own buy side software like Ad Studio) and most podcast listeners use SPOT as their #1 podcatcher, this will **create strong incentives for new advertisers to start their podcast ad journey with SPOT** (and onboarding more advertisers is absolute key!)

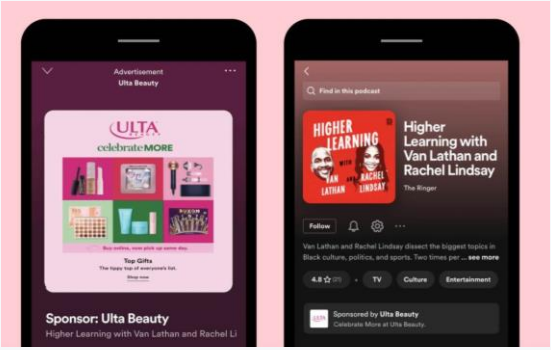
Image Source: Megaphone

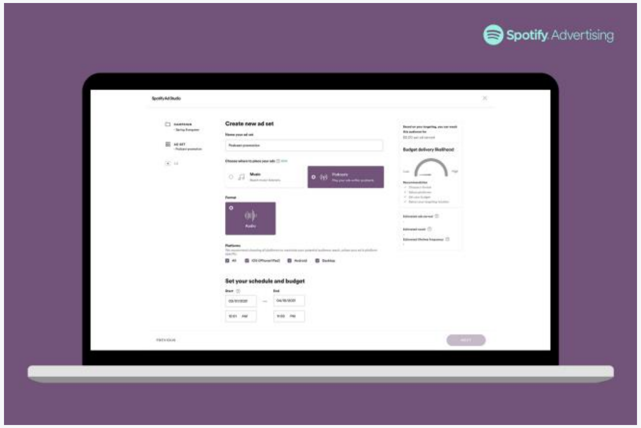
PODCAST ADS WILL EVOLVE AND INCLUDE MORE CTAS

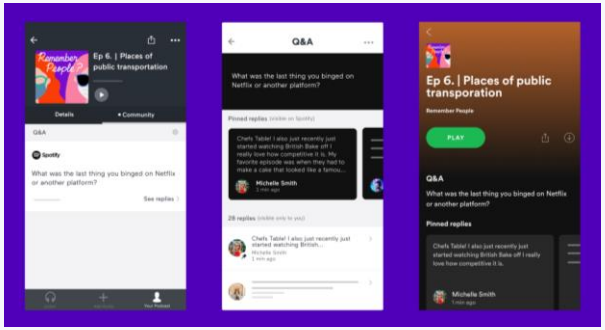
Over time, I think SPOT will introduce more direct response podcast ads and shopping integrations. With internet level targeting and measurement capabilities, this market is ripe to surpass spoken word radio ads.







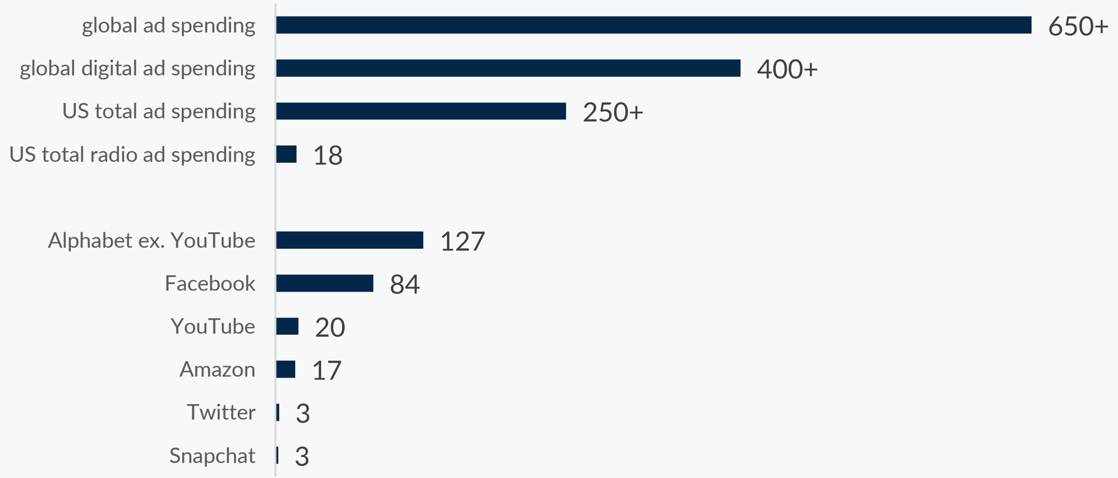




COMPARING PODCAST ADS TO RADIO = CONSERVATIVE

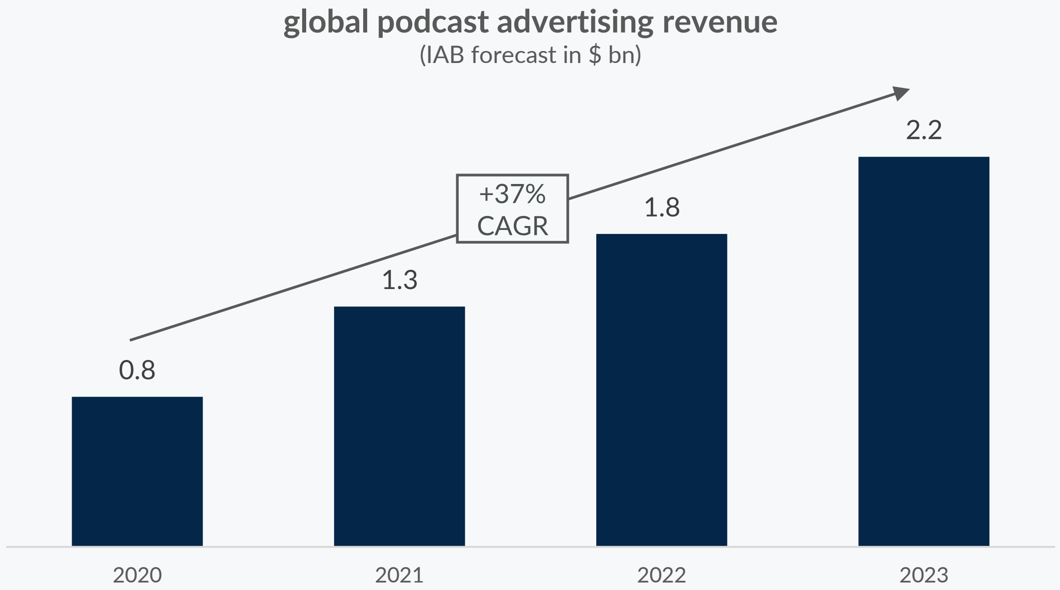
With internet level targeting and measurement capabilities SPOT podcast ads actually won't just compete with radio ads but with *all* digital advertising per se. This increases the potential market significantly.

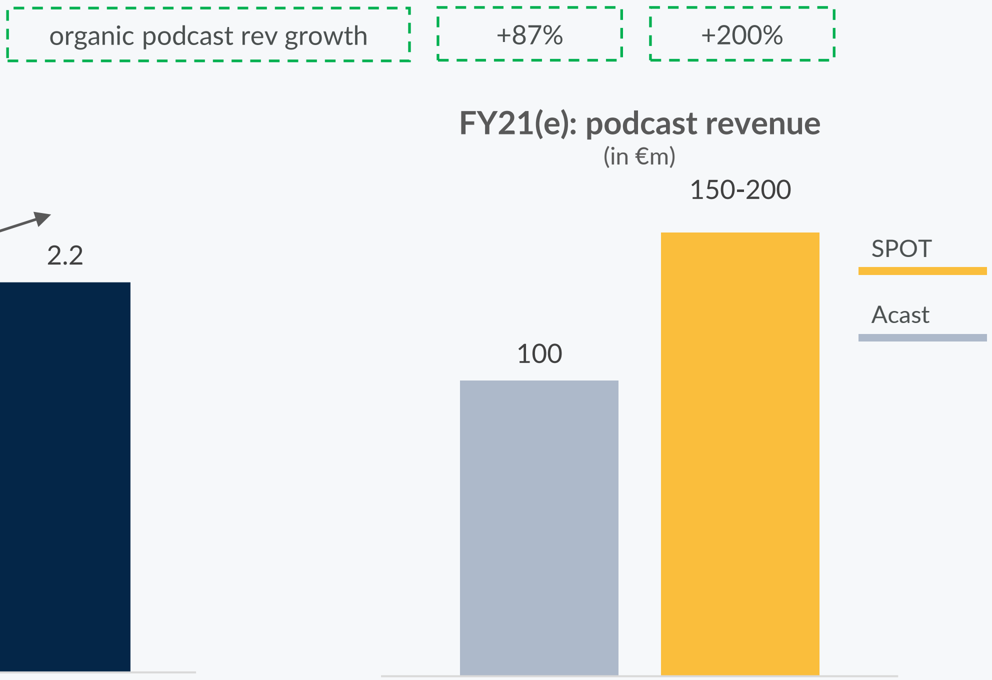
Reference points for the size of the advertising opportunity
(in $ bn)



SUMMING UP THE PODCAST AD OPPORTUNITY PART I

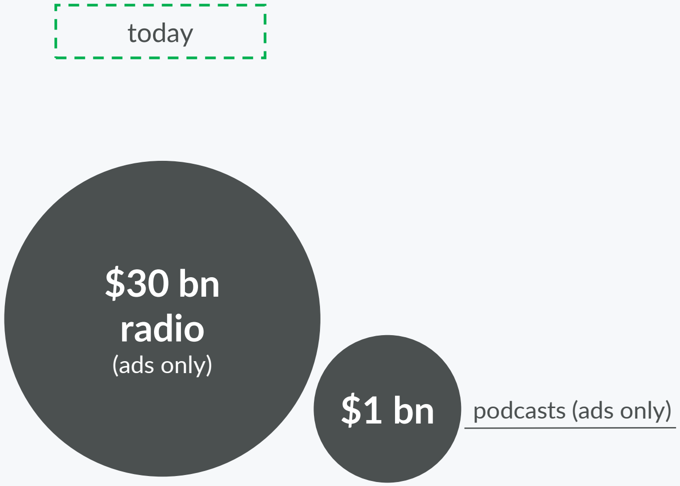
The entire podcast ad industry is growing 30%+ but the leading players in DAI are rapidly taking share. Acast/SPOT are growing 87%/200% on an organic basis and SPOT should make €150+m in podcast rev.

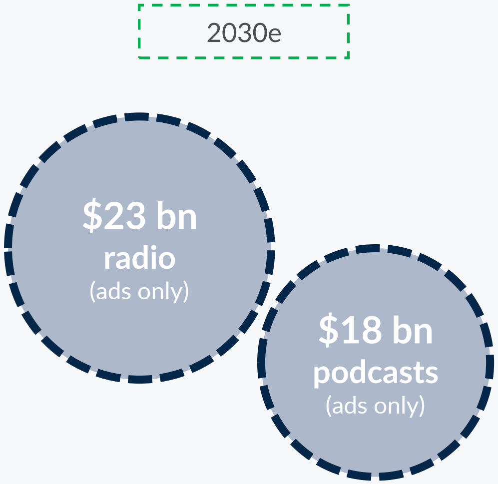




SUMMING UP THE PODCAST ADS OPPORTUNITY PART II

- Until 2030, **I expect *incremental* audio ad budgets flowing in large parts to podcasts**, which I can picture to be a $18 bn market by the end of this decade (30%+ CAGR)
- Contrary to some forecasts I expect radio ads to decline by just LSD p. a. and be a $23+ bn industry 2030e. **Advertising is always a "people business" and just as TV budgets have proven sticky vs. their usage decline, radio ad buyers will try to defend their role inside ad agencies** and keep their budgets as stable as possible





Data Source: own estimates

DATA POINTS SHOW SPOT'S INITIATIVES ARE WORKING

If one looks closely, more and more data points are validifying SPOT's audio-first strategy and their push into podcasts. While still in its infancy, advertiser demand for podcast ads is growing rapidly (which is key).

- *"And I'm especially inspired by the early success of the Spotify Audience Network. While we are growing the overall ads business from a small base, the potential is significant and the trend line is clear. We saw strong growth of 110% year-over-year. Adjusting for FX, the growth is even more impressive, coming in at 126%. And looking at podcasts,* ***podcast revenue was up over 627% year-over-year or nearly 200% on an organic basis. And the continued outperformance is currently limited only by the availability of our inventory, which is something we're actively solving for.*** *So it's clear to me that the days of our ad business accounting for less than 10% of our total revenue are behind us. And going forward, I expect ads to grow to be a substantial part of our revenue mix. So as you can see, there's a lot going on, and there's a powerful pipeline of platform improvements that will benefit consumers, creators and brand partners in Q3 and Q4."* – Daniel Ek, Q2/21 Earnings Call

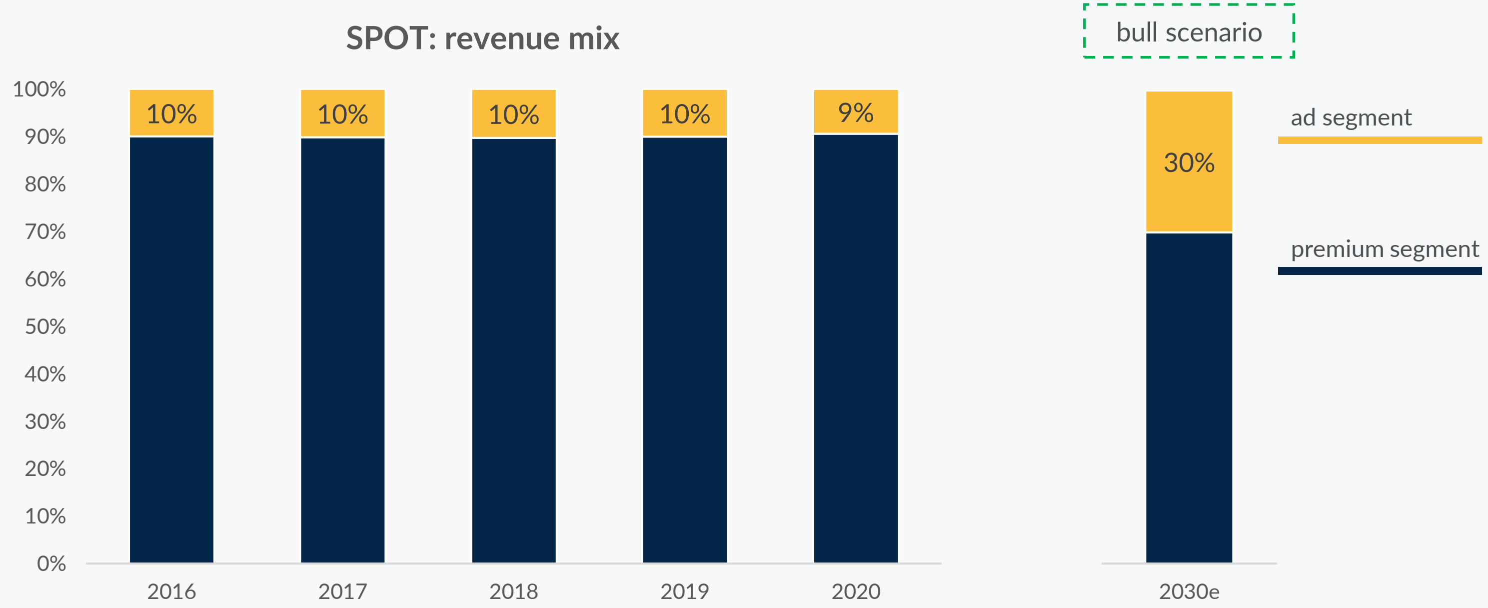
- *"Maybe just as an addition here, we've talked a little bit about this before, but I'll say it again.* ***We're mostly supply constrained and not demand constrained, meaning it's really more about us opening up more inventory than there being a lack of interest from advertisers in advertising with us.*** *So the really big effort for us at the moment is just how do we unlock even more supply for all the demand that we have."* – Daniel Ek, Q2/21 Earnings Call

- *"We're seeing bigger buys. I think as I mentioned earlier, when it comes to Megaphone, in general, we're seeing incremental budgets, incremental ads and we're actually monetizing at higher rates and so that's coming in.* ***And we're seeing just bigger overall spend from bigger brands.****"* – Paul Vogel, Q3/21 Earnings Call

ADVERTISING COULD BE 20% TO 30% OF SPOT'S MIX LT

If more and more advertisers start their podcast ad journey with SPOT, the ad segment – which has been an afterthought thus far – could not only generate substantial rev but also higher margins than premium.

- *"So I'm really excited about ads. I think we have had a tremendous quarter with 75% growth year-over-year. But this is just the beginning, as I stated in my opening remarks.* ***Long term, I believe at the very least, this should be 20% of our revenues, but it might possibly be a lot more than that, 30%, 40% even, over the next 5 to 10 years."*** – Daniel Ek, Q3/21 Earnings Call

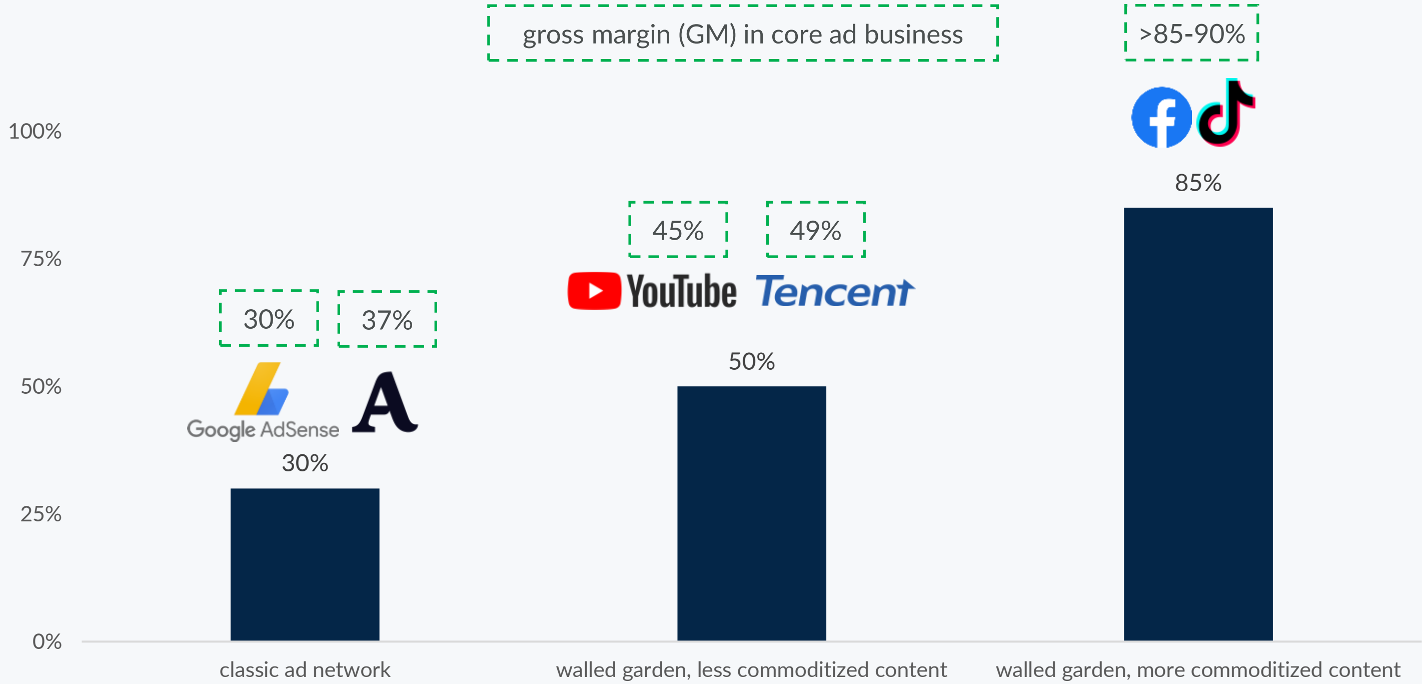


Data Source: company reports, own estimates

WHAT IS THE MARGIN POTENTIAL OF PODCAST ADS?

AdSense rev share is 70/30, Acast 70/30 or 50/50, YouTube 55/45, WeChat Mini Programs 50/50 and Meta 0/100 in favor of content creators. In podcast ads I expect SPOT can achieve YouTube-like margins.

- On *incremental* podcast ad dollars in O&Es* SPOT could generate 85-90% GM vs. e. g. only 30% GM in DAI delivered through Megaphone Targeted Marketplace (MTM) **for a blended GM of 45-50%** in podcast ads**



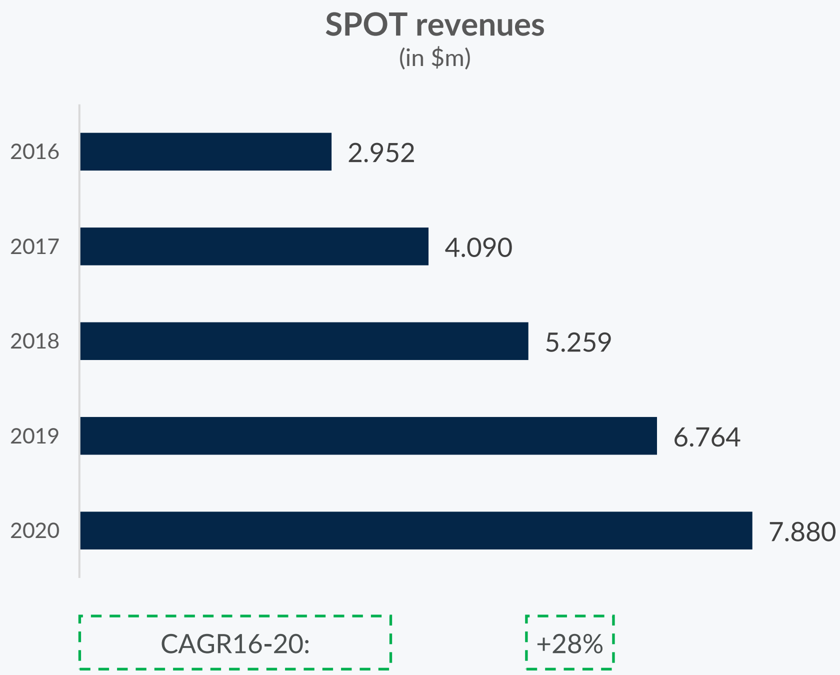
*O&Es today account for >20% of all podcast listening on SPOT

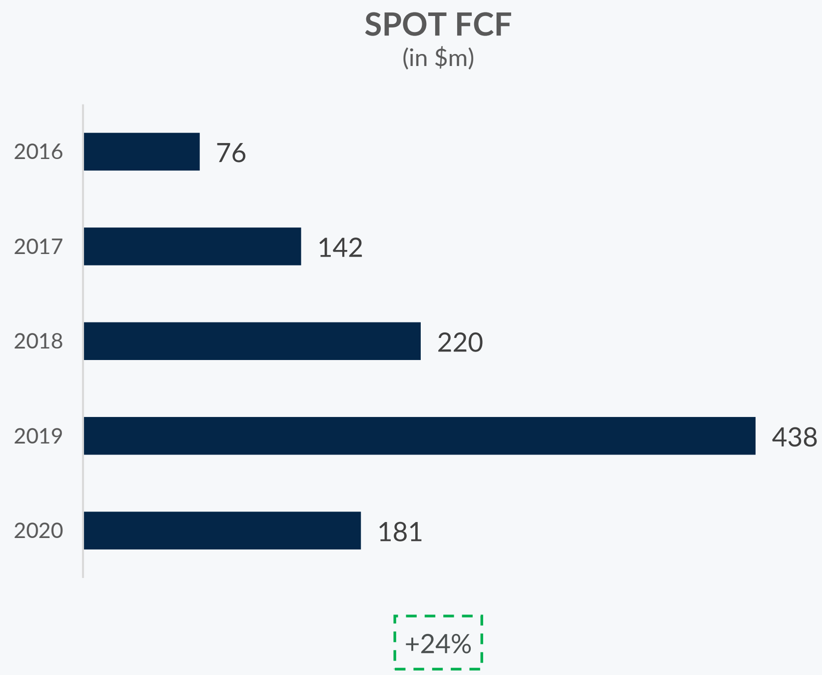
**as a x-check: Redcircle has no own DSP, no O&E podcasts and their rev share is 70/30 for host reads ads and 50/50 for DAI

FINANCIALS AND THOUGHTS ON VALUATION

SPOT IS P&L NEGATIVE, BUT CASHFLOW POSITIVE

SPOT never generated a full year profit, but FCF is positive due to negative WC. As long as the company grows and adds subscribers, the company increases its net cash because rightsholders get paid with a lag.





ARPU DECLINE HAS BEEN DRIVEN BY PRODUCT MIX

SPOT	PREMIUM ARPU	AD ARPU
2016	€6.20	€0.31
2017	€5.32	€0.37
2018	€4.81	€0.39
2019	€4.72	€0.37
2020	€4.31	€0,32
CAGR	*-8.7%*	*-0.3%*

SPOT standard plan prices

- India: €1.52 ($1.71)
- Phillippines: €2.47 ($2.78)
- Indonesia: €3.09 ($3.47)
- Brazil: €3.15 ($3.54)
- Thailand: €3.41 ($3.84)
- Mexico: €4.86 ($5.47)
- Australia: €7.58 ($8.53)
- Japan: €7.67 ($8.63)
- South Korea: €8.23 ($9.26)
- US: €8,88 ($9.99)
- Sweden: €9.65 ($10.86)
- Germany: €9.99 ($11.24)
- UK: €11.75 ($13.22)

Data Source: Spotify

SPOT MAY HAVE UNTAPPED PRICING POTENTIAL

Only recently did SPOT start experimenting with price increases. In the US SPOT raised the price of its family plan from $14.99 to $15.99 (+7%). SPOT also raised its prices in the Nordics with little pushback.

Pick your Premium

Listen without limits on your phone, speaker, and other devices.

VISA AMEX DISCOVER

raised from $14.99 in FY21

YOUR CURRENT PLAN

Individual
$9.99/month
1 account

- Listen to music ad-free
- Play anywhere - even offline
- On-demand playback

Duo
$12.99/month
2 accounts

- 2 Premium accounts for a couple under one roof
- Duo Mix: a playlist for two, regularly updated with music you both enjoy
- Ad-free music listening, play offline, on-demand playback

Family
$15.99/month
6 accounts

- 6 Premium accounts for family members living under one roof
- Family Mix: a playlist for your family, regularly updated with music you all enjoy
- Block explicit music
- Ad-free music listening, play offline, on-demand playback
- Spotify Kids: a separate app made just for kids

Student
$4.99/month
1 account

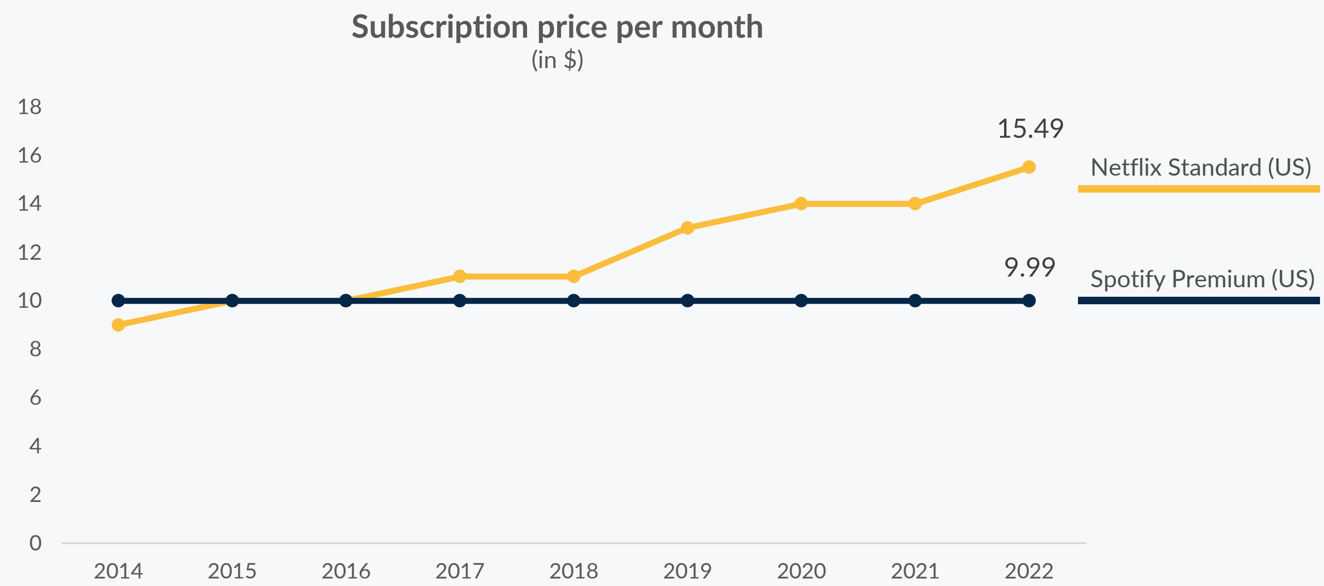
- Hulu (ad-supported) plan
- SHOWTIME
- Listen to music ad-free
- Play anywhere - even offline
- On-demand playback

Source: Spotify

COMPARED TO NETFLIX, SPOT IS MUCH CHEAPER

To offset geo mix in the future, SPOT will have to raise prices in more DMs where market share is high. At $9.99 in the US vs. Netflix standard $15.49 vs. cable TV $100+, SPOT has comfortable pricing headroom.

- **SPOT is 35% cheaper than NFLX standard in the US** and NFLX increased prices at 7% CAGR (SPOT: 0%)
- Spotify implemented its **first price hike in over 10 years in Norway in 2018 and lately got more active in raising prices** (US family plan raised from $14.99 to $15.99 and UK family plan from £14.99 to £16.99)

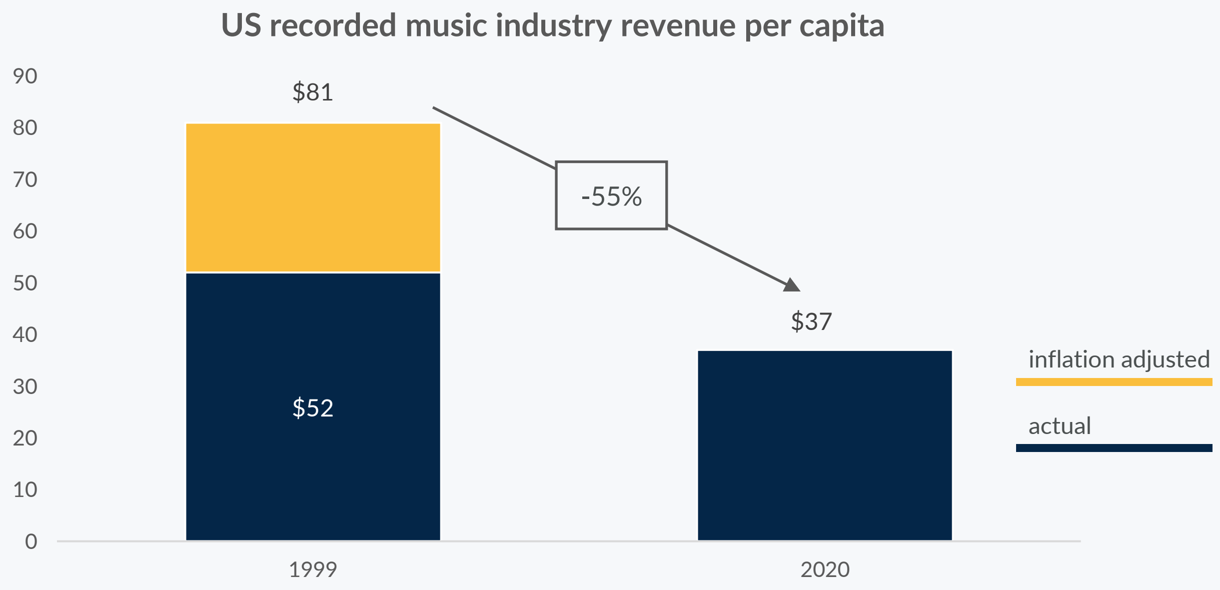


Data Source: Netflix, Spotify

SPOT COULD BE PRICED AT $20/MONTH OVER TIME

Inflation adjusted US recorded music rev per capita is well below the prior CD era peak. Technology brings quality adjusted prices down, but with more and more content added to SPOT, $9.99 is a clear bargain.

- Including **more audio content like podcasts, O&Es, meditation, audiobooks and live, I can easily picture a SPOT standard plan in mature markets to be priced around $20+** (which means +100% upside in pricing)



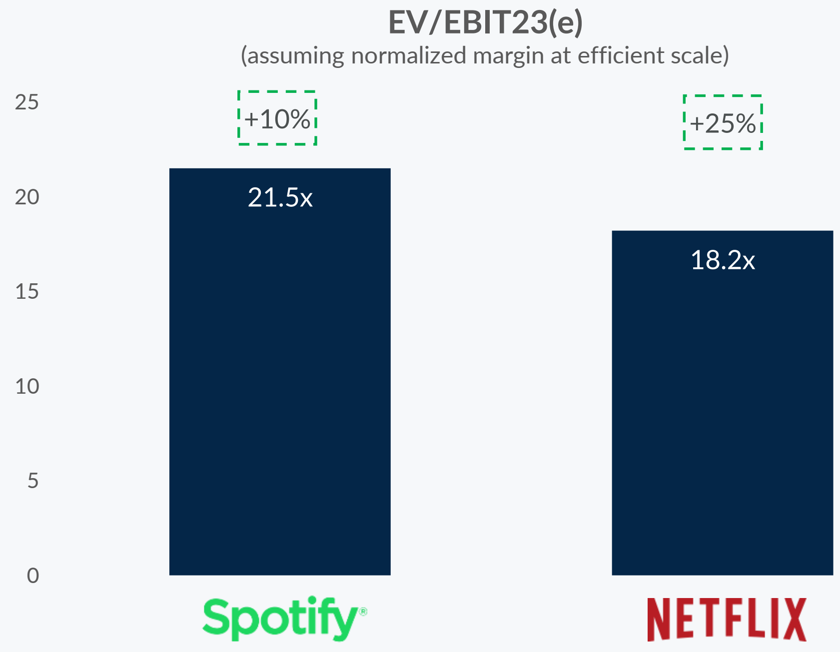
SPOT VS. NFLX: WHAT'S SIMILAR AND WHAT'S NOT?

The clearest difference between SPOT and NFLX is the 13PP margin differential in GM. This should allow NFLX to reach +25% normalized EBIT margins vs. only +10% for SPOT. EV/EBIT(normalized) looks similar.

FY20	Spotify	NETFLIX
revenue	9,001	24,996
COGS	6,699	15,276
GP	2,302	9,720
R&D	956	1,829
S&M	1,175	2,228
G&A	505	1,076
OPEX	2,636	5,133
EBIT	(335)	4,587

COMMON SIZE	Spotify	NETFLIX
revenue	100.0%	100.0%
COGS	74.4%	61.1%
GM	25.6%	38.9%
R&D	10.6%	7.3%
S&M	13.1%	8.9%
G&A	5.6%	4.3%
OPEX	29.3%	20.5%
EBIT	(3.7%)	18.4%

own estimates of normalized ebit margin potential



IN FY21 SPOT SET AMBITIOUS LONG-TERM TARGETS

At the FY21 "Stream On" event, SPOT upped its financial targets. Compared to 3 years ago, LT gross margin should reach 30-40% (30-35% prior), EBIT margin 10%+ and revenues should grow 20%+.

- I honestly don't know why SPOT put out a **20%+ LT rev growth target, which I'd judge as demanding***

COMPANY TARGETS	Q1/18 (without insights into Marquee and podcast initiatives)	Q1/21 (with first insights into Marquee and podcast initiatives)
revenue growth	25-35%	20%+
gross margin	30-35%	30-40%
EBIT margin	-	10%+
FCF	pos.	pos.

*Note that already three years ago, the company set revenue targets, they could not deliver against. One might say that COVID-19 came in between, but SPOT was a net beneficiary of the pandemic in CY20 and saw significant pull-forwards in MAUs/paid subs

THE BEAR, BASE AND BULL CASE FOR SPOTIFY

I rarely encounter a stock, where investors derive such a wide range of different valuation outcomes. SPOT's LT value depends on how one judges: its podcast strategy/core music margin pathway/sub trends.

- **Bear Case:** to be bearish on SPOT one would have to **view the company as a loss making, low gross margin commodity business, competing against global tech giants** with deep pockets which can bundle music into larger subscriptions and own proprietary smart speaker systems. One would have to expect SPOT misses its rev growth targets, suffers from ongoing declines in ARPU and slowing subscriber trends, **will always be squeezed by its powerful music suppliers and sets many hopes on a medium that 75% of its MAUs don't engage with** (podcasts). In this case the stock should trade at a discount to even its COVID-19 lows

- **Base Case:** to underwrite a base case for SPOT, one would have to believe that its exceptional founder led management team is directionally correct in their vision for the business and **can reach EBIT margins of 10% as well as 1 bn MAUs over time**. To increase gross margins, one would assume that the balance of power in label negotiations keeps shifting in SPOT's favor and that **Marquee/marketplace products will successfully be leveraged to play off the labels against each other in their fight for streamshare**. One would see the ad segment advancing from 10% to 20% of SPOT's mix at higher gross margins than the premium segment

- **Bull Case:** to be bullish on SPOT, one would have to believe in **a decade long shift in ear share from linear to on demand with SPOT remaining the clear market leader**. One would assume that SPOT will introduce ever more advertisers to podcast ads with SAI bringing internet level targeting and measurement capabilities to the tech stack. In such a case ads advance to >30% of SPOT's business mix until 2030 with **podcast ads generating YouTube-like economics and the premium segment hitting 34% gross margins based on an ongoing success of the two-sided marketplace**. In a bull case SPOT would more than offset ARPU pressures from geo mix through price increases and **achieve EBIT margins ~15% before the end of this decade**

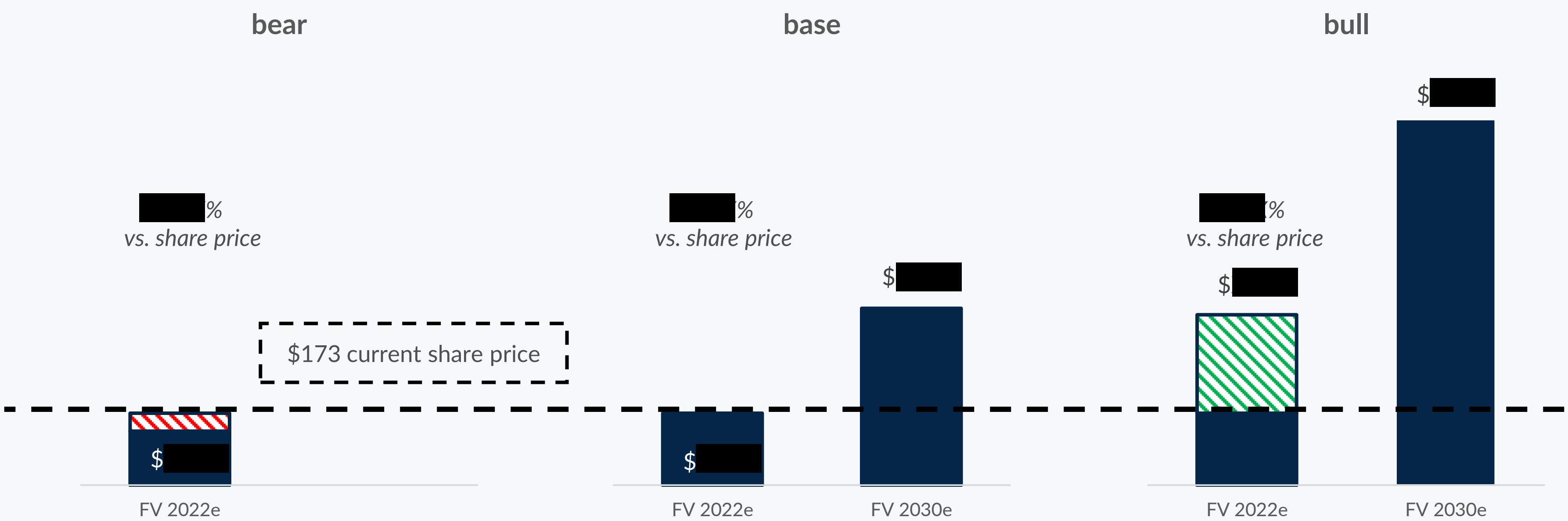
SCENARIO ANALYSIS

SCENARIO ANALYSIS	BEAR	BASE	BULL
price per share today	$173	$173	$173
FV per share 2030(e)	-	$[redacted]	$[redacted]
FV 2022(e)	$[redacted]	$[redacted]	$[redacted]
% upside/downside vs. price per share	[redacted]	[redacted]	[redacted]
required IRR from FV 2022(e)	-	*+12.5% p. a.*	*+10.0% p. a.*
paid subs 2030(e)	-	430m	430m
MAU 2030(e)	-	968m	968m
revenue (total) 2030(e)	**-**	**$28,913**	**$32,703**
thereof: premium subscriptions	-	$23,310	$23,310
thereof: podcast advertising	**-**	**$2,474**	**$7,100**
gross margin (premium) 2030(e)	-	*33.1%*	*34.0%*
gross margin (podcast ads) 2030(e)	-	*45.0%*	*50.0%*
gross margin (total) 2030(e)	-	*33.7%*	*36.7%*
OPEX in % of rev 2030(e)	-	*22.5%*	*22.0%*
EBIT 2030(e)	**-**	**$3,234**	**$4,813**
EBIT in % of rev	-	*11.2%*	*14.7%*
net cash + TME stake 2030(e)	-	$12,995	$18,018
exit multiple core business	[redacted]x rev	[redacted]x EBIT	[redacted]x EBIT

[redacted] *redacted on purpose due to compliance reasons.

FAIR VALUES BASED ON THE BEAR/BASE/BULL CASE

Based on its anticipated revenue/margin potential, SPOT's stock already prices in some success of its audio-first/marketplace strategy. Only the bull case at $[redacted] in 2030e seems to be heavily discounted.



[redacted] *redacted on purpose due to compliance reasons.

DISCLAIMER: this presentation is for informational purposes only. It is **no investment advice** and **no financial analysis**.

WILDCARD I: SPOT COULD PUSH MORE INTO SOCIAL

Music is inherently social. ByteDance's Resso made social functions (sharing, commenting) front and center of their UX. In my opinion SPOT has room for improvement here, but could catch up quickly.

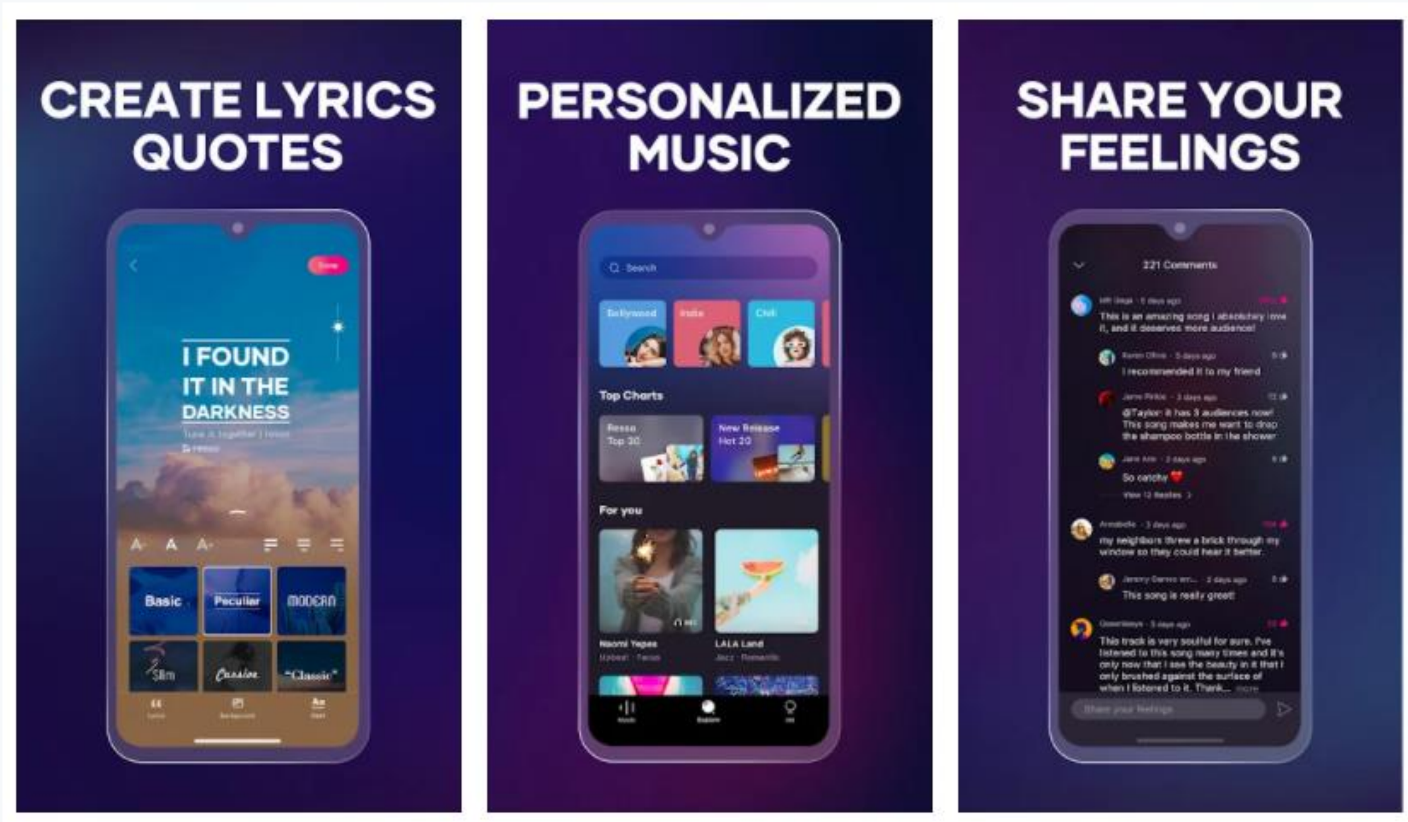


Image Source: ByteDance

WILDCARD II: GREENROOM GOES AGAINST CLUBHOUSE

If I was Clubhouse, I'd be watching SPOT's acquisition of Greenroom closely. SPOT has a much larger user base (+400m MAU vs. +10m for Clubhouse) and could integrate Greenroom into its main app if suitable.

- SPOT is the **de facto standard for a place where users want to consume audio. Everybody who opens an audio room to discuss a topic needs a minimum number of listeners** to make things worthwhile. SPOT has tools to convert live talks to podcasts which could later be distributed/monetized via Anchor/Megaphone

Image Source: Spotify

CONCLUSION

CONCLUSION: WHAT IS THE CONSENSUS OPINION?

To conclude: I think the Street still sees SPOT as a MAU growth story (net adds surprises send the stock up/down each quarter), when in fact it's more and more shifting to a *monetization story* of 400+m users.

"SO AS YOU LOOK AT THE BALANCE OF THE YEAR, ONE OF THE MOST MEANINGFUL PUTS AND TAKES THAT WE SHOULD BE THINKING ABOUT IN TERMS OF YOUR ABILITY TO DELIVER A STRONGER SECOND HALF IN TERMS OF MAU NET ADDS. I MEAN, EVERYBODY SEEMS TO BE FOCUSED ON THIS."

- WALL STREET ANALYST, BOFA MEDIA, COMMUNICATIONS & ENTERTAINMENT CONFERENCE 2021

→

"I THINK REALLY, THE BIG THING YOU ALL AS ANALYSTS SHOULD FOCUS ON IS THE SHIFT OF SPOTIFY AS A PREMIUM SUBSCRIPTION MUSIC SERVICE TO AN AUDIO PLATFORM. AND THAT AUDIO PLATFORM MEANS THAT THE BUSINESS MODEL FUNDAMENTALLY OF SPOTIFY NOW IS VERY DIFFERENT THAN WHAT IT HAD BEEN IN THE PAST. AND YOU'RE STARTING TO SEE THAT SHIFT COME THROUGH WITH ADS. BUT I SUSPECT OVER TIME, THERE'LL BE MANY MORE TOOLS AND SERVICES THAT WE ARE DRIVING AND DELIVERING HERE THAT WILL THEN ALL START IMPACTING THE OVERALL RESULTS IN DIFFERENT WAYS OF THE BUSINESS GOING FORWARD.

- DANIEL EK, Q2/21 EARNINGS CALL

Thank you for your interest! If you enjoyed this presentation → SUBSCRIBE HERE

Further read: H2/21 Letter from befriended investor CL Capital on SPOT → LINK

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