

Spotify Technology

Profitability push continues into new year

Reiterate Rating: BUY | PO: 265.00 USD | Price: 223.25 USD

4Q results: Net adds and MAUs beat our expectations.

Spotify (SPOT) reported a strong 4Q as gross margins, MAUs, premium subscribers, operating income and FCF were above our forecast while revenue was modestly below. All in, total 4Q23 revenue grew +16% Y/Y (20% ex FX) to €3,671mn (vs. our €3,705mn est.), reflecting ~300bps of sequential acceleration vs. 3Q (constant currency), driven by 17% growth in Premium revenue and 12% in ad-supported revenue on a reported basis. Gross profit grew +22% Y/Y to €980mn (vs. our €984mn est.) reflecting: (1) lower premium rev. of €3,170mn (vs. €3,205mn est.) and inline ad-supported revenue of €501mn (vs. €500mn est.) and (2) modestly better gross margins (26.7% vs. our 26.6% est.)—reflecting improvement in podcast profitability and music profitability, other Cost of revenue favorability partially offset by Audiobooks start-up costs and €4mn in net severance related charges. MAUs were 602mn (vs. our 601mn est.) which was driven by double digit Y/Y growth in all regions with particular outperformance in Latin America and ROW. Operating income of -€75mn (vs. our -€100mn est.) benefitted from lower marketing spend and lower personnel costs. Excluding €143 million in charges associated with efficiency actions, 4Q adjusted OI was €68mn.

1Q guide reflects continued profitability push

SPOT's 1Q guidance indicates continued momentum in MAUs and Premium subscribers which were above our forecast and revenue that is directionally inline. SPOT projects 1Q revenue of €3.6bn (including 250 bps headwind from FX vs. our €3.64bn est.) and total MAUs of 618mn (vs. our 611mn est.). Premium subscribers are expected to be 239mn (vs. our 236mn est.) while gross margins are forecasted to be 26.4% (vs. our 26.6% estimate) and operating income is projected to be €180mn (vs. our €103mn).

Premium subs modestly ahead of our forecast

Reported premium rev. grew +17% (vs. +18% est.) and +21% excl. FX, reflecting subscriber growth of 15% Y/Y (vs our 15% est.) and a modest Y/Y increase in ARPU (average revenue per user) to €4.60 (vs. €4.64 est.). ARPU grew +1% Y/Y (5% excl. FX) and was driven by price increases partially offset by product and market mix.

Advertising revenue hits all time high

Ad-supported revenue grew +12% (vs. +11% est.) driven by growth across all regions. Music ad-supported revenue grew double digits Y/Y benefitting from growth in impressions sold and stable pricing. Podcast revenue growth remained in the healthy double-digit range driven by significant Y/Y growth in sold impressions across Original and Licensed podcasts and Spotify Audience Network, partially offset by softer pricing.

Reiterate Buy and raise our PO to \$265

We reiterate our Buy rating and raise the PO to \$265 from \$225 which is based on our updated DCF valuation. We lower our DCF discount rate to 12.3% (from 12.8%) to reflect SPOT's better operating performance and contributions from new business lines. We will revisit our estimates post-earnings call. We remain bullish on the long-term potential of SPOT, which should benefit from an improvement in advertising and deeper penetration in existing markets. Furthermore, we think price increases as well as management's recent commentary and actions on expenses should drive continued improvement in the underlying margin trajectory of the business.

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Timestamp: 06 February 2024 08:20AM EST

06 February 2024

Equity

Key Changes

(EUR)	Previous	Current
Price Obj.	US\$225.00	US\$265.00

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Stock Data

Price	223.25 USD
Price Objective	265.00 USD
Date Established	6-Feb-2024
Investment Opinion	C-1-9
52-Week Range	114.64 USD - 224.45 USD
Mkt Val (mn) / Shares Out (mn)	44,314 USD / 198.5
Free Float	61.7%
Average Daily Value (mn)	364.21 USD
BofA Ticker / Exchange	SPOT / NYS
Bloomberg / Reuters	SPOT US / SPOT.N
ROE (2023E)	-21.7%
Net Dbt to Eqty (Dec-2022A)	-103.4%
ESGMeter™	High

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est: estimates

KPI = Key performance indicator

MAU = Monthly active user

rev: revenues

ROW: Rest of the World

vs: versus

Exhibit 1: SPOT – Variance Table

SPOT's 4Q OI of -€75mn beat our estimates

Fiscal Year Ends 12/31	Current Quarter						
	Guide	Act.	Act.		Old		
SPOT: BofAS Estimate Revisions	4Q23	4Q22A	4Q23A	Y/Y	4Q23E	Y/Y	D
Monthly Active Users (MAUs) (mns)	601	489	602	23%	601	23%	1
Net MAU Additions (Losses) (mns)		33	28	-15%	27	-18%	1
Premium Subscribers (mns)	235	205	236	15%	235	15%	1
Net Subscriber Additions (Losses) (mns)		10	10	0%	9	-10%	1
Ad-Supported MAUs (mns)		295	379	28%	379	28%	0
Premium ARPU		€ 4.55	€ 4.60	1%	€ 4.64	2%	-€ 0.04
Revenues							
Premium		€ 2,717	€ 3,170	17%	€ 3,205	18%	-€ 35
Ad-Supported		€ 449	€ 501	12%	€ 500	11%	€ 1
TOTAL Revenue	€ 3,700	€ 3,166	€ 3,671	16%	€ 3,705	17%	-€ 34
TOTAL Cost of Revenue		€ 2,365	€ 2,691	14%	€ 2,721	15%	-€ 30
TOTAL Gross Profit		€ 801	€ 980	22%	€ 984	23%	-€ 4
Margin %	26.6%	25.3%	26.7%	--	26.6%	--	0.1%
Research and Development		€ 415	€ 468	13%	€ 468	13%	€ 0
Sales and Marketing		€ 453	€ 432	-5%	€ 451	-1%	-€ 19
General and Administrative		€ 164	€ 155	-5%	€ 166	1%	-€ 11
EBITDA		-€ 181	-€ 41	nm	-€ 67	nm	€ 26
Depreciation and Amortization		€ 50	€ 34	-32%	€ 33	-34%	€ 1
Operating Income	-93 to -108	-€ 231	-€ 75	nm	-€ 100	nm	€ 25
Net Income (Loss)		-€ 270	-€ 70	nm	-€ 80	nm	€ 10
EPS		-€ 1.40	-€ 0.36	nm	-€ 0.40	nm	€ 0.04
FCF		-€ 73	€ 396	nm	€ 172	nm	€ 224
FCF/S		-€ 0.38	€ 2.02	nm	€ 0.87	nm	€ 1.15

Source: BofA Global Research estimates

BofA GLOBAL RESEARCH



Price objective basis & risk

Spotify Technology (SPOT)

Our \$265 price objective is based on a DCF valuation, driven by a discount rate of 12.3% and a 9% terminal growth rate. Our valuation accounts for SPOT's positioning within a secular growth area of Media & Entertainment, its ramping profitability, and the premium valuations ascribed to leading subscription streaming media services.

Upside risks to our price objective are faster-than-expected revenue growth, margin expansion, increased market share, increased operating leverage, and traction from new growth initiatives.

Downside risks to our price objective are margin pressure, increased content costs, reduced streaming market share, slower revenue growth and the potential that the Joe Rogan controversy drives an increase in churn or artists pulling their songs from the platform.

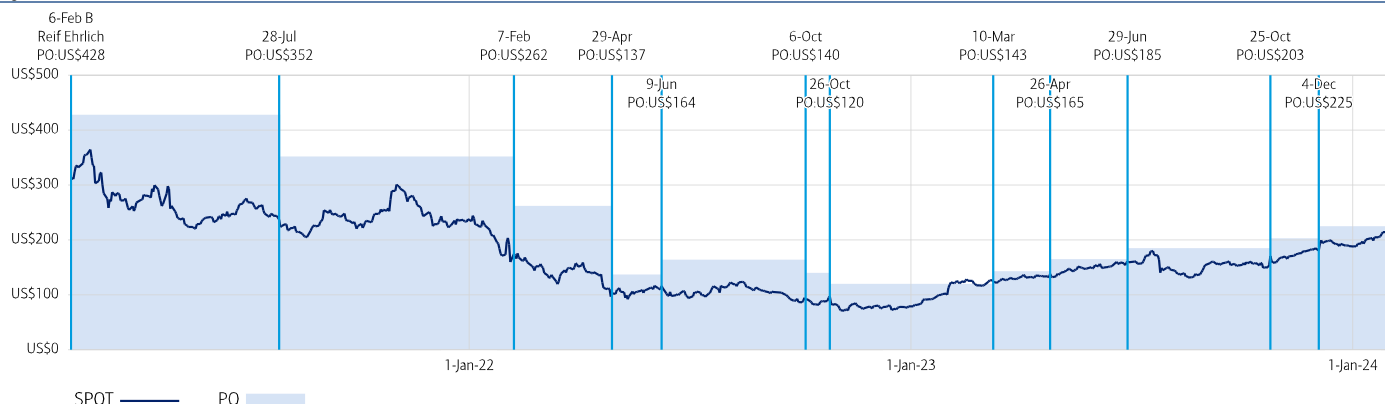
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Spotify (SPOT) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Media & Entertainment Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	35	53.85%	Buy	15	42.86%
Hold	15	23.08%	Hold	8	53.33%
Sell	15	23.08%	Sell	7	46.67%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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