

COMMERCIAL DUE DILIGENCE MEMORANDUM

Target Asset: Spotify Technology S.A. (SPOT)
Sponsor: Deal Team (Analyst: H. Singh)
Date: January 6, 2026

1 EXECUTIVE SUMMARY: THE "GROWTH TRAP"

Recommendation: PASS / SHORT.

Rationale: Despite headline growth in subscribers (+12% Y/Y), the unit economics have deteriorated. Our analysis reveals an LTV/CAC ratio of **0.91x on Net Adds**, implying that current paid acquisition is value-destructive.

- **Unit Economic Inversion:** The cost to acquire a net new subscriber (€69.80) exceeds the Lifetime Value of that subscriber (€63.23). The business is solvent only due to organic (unpaid) funnel conversion, which is masking the inefficiency of paid spend.
- **Margin Dilution from New Formats:** Premium Gross Margins compressed to **33.2%** (down 34 bps Y/Y). Management cites "video podcast costs" as the driver, confirming our thesis that diversifying beyond music introduces lower-margin media costs rather than software-like scalability.
- **Ad-Supported Stagnation:** While Ad-Supported MAUs grew 11%, Ad-Supported Revenue was **flat (0%)** on a constant currency basis. The "monetization gap" is widening, not closing.

2 MARKET STRUCTURE & COMPETITIVE POSITION

Spotify defends a leading position but faces asymmetric competition.

Table 1: Q3 2025 Operational Snapshot

Metric	Value	Y/Y Growth	Implication
Total MAUs	713 Million	+11%	Top-of-funnel remains strong
Premium Subs	281 Million	+12%	Conversion is holding steady
Ad-Supported Revenue	€446 M	-6% (Reported)	Monetization broken in developing markets New verticals are margin dilutive
Premium Gross Margin	33.2%	-34 bps	

3 UNIT ECONOMICS: THE "CHAINSAW" ANALYSIS

We have modeled the Q3 2025 financials to isolate the value drivers.

Note: Analysis uses Q3 Revenue against Average Q3 Subscribers (Mean of Q2 end and Q3 end).

Table 2: Unit Economics Breakdown (Premium Segment) - Q3 2025

Metric	Value	Source / Calculation
Premium Revenue	€3,826 M	Q3 Reported
Avg. Subscribers	278.5 M	(276M Q2 End + 281M Q3 End) / 2
Monthly ARPU	€4.58	Rev / (Avg Subs × 3)
Gross Margin %	33.2%	Reported
Contribution Margin	€1.52	ARPU × GM%
Est. Lifetime	41.7 Months	Assumes 2.4% Monthly Churn
LTV (Lifetime Value)	€63.23	Contribution × Lifetime

4 MARKETING EFFICIENCY (THE "RED FLAG")

Comparing the Lifetime Value against the cost to acquire reveals the structural weakness in the "Growth at All Costs" model.

- **Sales & Marketing Spend:** €349 Million (Est).
- **Net New Subscribers:** 5.0 Million (281M - 276M).
- **CAC (Net Basis):** $349\text{M}/5\text{M} = 69.80$.

LTV / CAC Ratio: 0.91x

Verdict: The cost of adding a net new subscriber exceeds their projected lifetime profit.

5 CASH FLOW & WORKING CAPITAL

While P&L margins are thin, the Balance Sheet offers a temporary LBO lever.

- **Mechanism:** Premium users pay monthly in advance; Royalties are paid on Net 60 terms.
- **Free Cash Flow:** €806 Million in Q3 2025.
- **Risk:** This FCF is a function of timing differences, not operating profit. As subscriber growth slows (approaching saturation in NA/Europe), this "float" benefit will unwind.

6 FINAL INVESTMENT VERDICT

Pass. The asset trades at a Tech valuation (EV/Revenue) but possesses Media economics (Variable Cost). The deterioration of Premium Gross Margins to 33.2% despite price increases indicates that the "Unit Economics Escape Velocity" thesis is flawed. The new verticals (Audiobooks/Video) are adding revenue but compressing margins.