PROPSAL FOR SPOTIFY TO AQUIRE PELOTON

Team PKBS

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Executive Summary

Group PKBS is proposing that Spotify should diversify their product offering in a strategic plan consisting of expanding into the digital exercise content industry. After careful consideration, performing due diligence on an array of firms, we are proposing Spotify's strategic acquisition of Peloton.

Spotify, which operates in the music streaming industry, benefits from the expected ~10% CAGR for the next 6 years driven by the dramatic increase in paid subscriptions post-COVID due to increased leisure and remote time. Further internet penetration from global cellular infrastructure, smartphone usage, and digitalization of music has propelled the industry and Spotify to the forefront of consumers. They serve as a dominant player in the music streaming industry, and their innovation and product line expansion in recent years has helped promote this.

Peloton, on the other hand, operates in the home fitness equipment industry. This industry expects ~7.6% CAGR for the next 6 years driven by the growing residential infrastructure and the wide fitness consensus concerns. A large issue for Peloton, like any asset heavy industry, is their overhead costs and streamlining these operational efficiencies. These high costs have led Peloton to take on large amounts of debt in attempts to foster growth and brand awareness.

Group PKBS believes Spotify should go through a friendly acquisition approach for Peloton due to various overlapping board of directors within each of the companies. The interconnectedness of boards promotes the possibility of achieving more operational and financial synergies post-merger and helps condense costs and promote growth of future cash flows. Further, we believe that the combination of these digital platforms should help draw current users of either service to the opposing service as well, which can help Spotify better reach its long-term strategic goals.

In addition to these benefits, we feel that Spotify is in a position where they need to make a big strategic move to maintain their competitive advantage and control in their industry. Platforms in the music streaming industry are continuing to reinvest heavily into personal content in aim to keep users engaged and committed. Most firms are not innovating beyond audio streaming experience enhancement. Since Spotify is known and commended for their advancements in this area given their innovation in recent years, they already have the recognition these other firms are seeking. This makes Spotify's acquisition of Peloton very lucrative as they can set themselves apart even further with a whole new branch of personalized content through Peloton.

Spotify has significant Cash levels at $4,884.4M and Free Cash Flow of just over $1,500M which will allow them to make a 100% cash offer. The deal structure will be similar to a reverse triangle merger allowing Peloton to act as a subsidiary and remain intact. The expected synergies from this deal will exploit cross-promotional opportunities to leverage the combined user base and drive growth for the combined entity.

Rough estimates show the present value of synergies to be $8,819.7M, and it's driven by increased operational margins and anticipated revenue improvements. This transaction would offer Peloton Shareholders a 12.3% - 20% premium on their shares and the opportunity to join a company whose increased their earnings by ~153% within the past year. The transaction process itself is estimated to take around 14 months to complete, from first contact with Peloton to deal close, and will cost Spotify roughly $1.9 million in transaction fees.

This merger can benefit all sides of the business for Spotify as it should create a new revenue stream, grow their current platform more, and better financial performance. For Peloton, this deal will revive a struggling business after their decline post-COVID. Spotify's access to capital should help create a revolutionary player in the home fitness space.

Business Plan

Spotify is a digital music streaming service that provides users access to digital content in the form of millions of songs, podcasts, and videos. It provides access to content from artists and creators from all around the world, including over 100 million songs and other digital content. Spotify's applications on mobile devices are popular, easy to use, and free to download on all major providers. With over 600 million users, of which 230 million are paid subscribers, Spotify is one of the most popular music platforms. (10)

Industry and Market Definition

The broad market definition that Spotify operates in is the music streaming industry. This is a subset of the much larger entertainment industry. The definition of the music streaming industry is categorized as the industry for online access to music and audio content. This industry is very similar to the video streaming industry. However, there is very little crossover in the industry in terms of user interface. The music streaming industry has dominated other forms of music consumption, with physical media, downloads, and radio market shares consistently declining since streaming services first lanuched. Many streaming services partner with artists and live performances. Spotify has many competitors. Some of the more well-known services include Apple Music, Amazon Music, Sirus XM Radio, YouTube Music, Pandora, and Deezer.

Spotify operates globally. Several factors drive the market's current success. These include increasing internet penetration, smartphone usage, and digitalization of music. Consumers are also driving the market with strong preferences for personalized and convenient listening experiences. As of 2023, there were 649 businesses in the industry; however, only a handful are considered main competitors to Spotify[(1)]. The market size of the US music streaming industry was estimated at $17.7 billion in 2023 and is expected to grow at a compound annual growth rate (CAGR) of 9.9% [(1)]. The market is also characterized by high competition, innovation, and differentiation among various players.

External Analysis

Spotify faces many external challenges in the dynamic industry it operates in. First and foremost are it's demands from customers. They are a global group of music listeners who want access to a large and ever-growing library of content. Although there are two types of subscriptions (free and paid), both want access to all the content possible with either a minimal amount of ads or at a low cost. Customers are also seeking highly personalized experiences to navigate through the large content libraries. Social media, marketing campaigns, and word of mouth highly influence this group of customers, and they could be convinced to switch to the newest and latest platform if Spotify publicly missteps and is not actively countered by Spotify.

There are many competitors to the Spotify platform as previously mentioned. Many customers are very loyal to their chosen platform, and many won't consider switching unless a good reason is provided. Therefore, it is important to find and attract customers with offerings that competitors do not have. For instance, Spotify differentiates itself from competitors by offering live radio, high-fidelity sound, integration with smart devices such as speakers, phones, and watches, and primarily with curated playlists.

There are several possible avenues for new entrants. These include video streaming services like Netflix or Disney or Social Media outlets like Facebook that may try to break into the market. These services may offer highly curated music using new tools available through AI. However, the large resources of these major business companies are the true threat as they can launch massive advertising campaigns and buy up rights to popular music. Any new entrants could decrease Spotify's users and subscribers, cutting revenue and profitability.

Content generators are a large global group of dynamic artists and podcasters that have high bargaining power. The content generators would be considered suppliers for Spotify. These suppliers populate the content library. If a content generator restricts access to their content and provides it to any of Spotify's competitors, Spotify can immediately lose customers, especially if high-profile artists such as Taylor Swift and Beyonce or podcasters such as Joe Rogan were to restrict content. These suppliers can exert their leverage and make demands on Spotify.

Internal Analysis

Looking inward, we can determine significant strengths and weaknesses when analyzing the key areas of their business between Brand, Employees, Management, Production Process, and Intellectual Property

Brand: Spotify has gained a market leader presence within the music streaming industry, boasting the largest user base and are considered the "go-to-platform" for all music listeners. This brand reputation has developed loyal customers due to their unique features enhancing the individual user experience. The user-friendly interface, personalized playlists like discover weekly, and podcast integration all contribute towards a comprehensive music experience. Weaknesses of their brand could be pointed towards many free tier dependency users who limit potential revenue combined with exclusivity deals that many artists have signed that limit the company's ability to maximize music availability and financial performance.

Employees: One of Spotify's biggest strengths is their internal workforce as they have been able to out hire many of the top skilled computer engineers from the likes of Google, Amazon, and Apple. This originated from establishing themselves as a new up and coming music platform that got many engineers excited about the potential job path. These skilled engineers have pioneered many features that innovated the entire music streaming industry. AI based playlists, time-of-day similarities, discover weekly, and their now famous Spotify Wrapped has put them in the forefront of the industry. Potential weaknesses that arise from this fast growth is the risk of burnout from these personnel in keeping up with this environment of innovation, along with the general cost Spotify must commit to hire these workers over the likes of Google, Amazon, Facebook.

Management: Spotify remains successful with a robust proven track record of C-suite hires combined with well-versed independent directors to ensure outside shareholder interests are represented. Their C-suite also has a long reputation of prioritizing innovation through research and development spending, ensuring that Spotify remains at the forefront of the music streaming industry. A major weakness that surrounds their strategic breadth is the large dependence on music streaming which could limit the company's ability to adapt to changing consumer preferences down the line. This is where a strategic acquisition in a tangential industry could provide immense benefit to combine similar consumer types.

Production Process: Since its inception, Spotify has ensured that its platform remains scalable, allowing them to take on global growth and handle millions of users simultaneously streaming music. Their patented algorithms within their code also ensure that on top of scalability, every individual user experience is driven by personalization and customization. Their network and compatibility through other applications allow for a smooth and reliable streaming service regardless of the activity or location. A major weakness stemming from these personal algorithms, like any technology company, is data security. Spotify is protecting vast amounts of user data which could be detrimental to both their brand image and customer loyalty if there was a security breach detected.

Intellectual Property: As mentioned in the above sections, Spotify's core competencies revolve around their specific music recommendation and playlist generation algorithms. These are branded trademarks and recognized by many consumers as the most accurate. Competing platforms are lagging in these two areas and promote the recognition of Spotify's competitive advantage and expansion of market share. On the other hand, Spotify still relies on licensing agreements with record labels, which limits the promotion of some content within their library while some other platforms might contain more niche (remixes, smaller artists, etc.) music for listeners.

Opportunities & Threats

The most crucial opportunities and threats that Spotify must tackle based on its internal business advantages should surround market expansion, content diversification, technological innovation, and original content production. There has been a recent surge of mobile penetration with growing internet access throughout the world, which leaves untapped potential to expand towards more user base growth. Spotify also has a significant opportunity to capture a large share and redefine what it means to be a music streaming platform by expanding to more podcasts, audiobooks, and even live events to make a more comprehensive entertainment platform. Furthermore, investing more towards their own personal infrastructure to decrease reliance on CDNs (Content Delivery Networks) can help them leverage AI for further personalization and embrace new audio formats for their users. Finally, original content creation can stretch this competitive divide, separating themselves from their competitors and fostering user loyalty.

These opportunities come with their own plausible threats, consistent competition from major market capitalization competitors, shifting consumer preferences, and potential poaching of key personnel. Apple Music, Amazon, and others are all putting cost pressures to dig into Spotify's market share and have much more capital to put towards these innovations than the specific resources Spotify has available. The recent shift towards music consumption has joined the 7 seconds of fame style of TikTok. Many people now consume various short-form video remixes of songs that are not featured on Spotify, which has the potential of reducing user activity and premium subscriptions. The last threat might be what worries Spotify the most, and that is the poaching of their key computer engineers to FAANG (Facebook, Apple, Amazon, Netflix, Google), which could lead to strategic mistakes or hinder long-term innovation. Focusing on these key opportunities and threats can help Spotify continue to solidify its position in the ever-evolving music streaming landscape.

Business Mission/Vision Statement

Spotify recognizes its mission in the following statement: "Spotify's mission is to unlock the potential of human creativity by giving a million creative artists the opportunity to live off their art and billions of fans the opportunity to enjoy and be inspired by it [(3)]. To help achieve this, Spotify has continually emphasized innovation and transformed its offerings to maintain a competitive edge over its competitors since its inception in 2008. They believe that "Innovation is at the core of what we do, and we continually work to deliver the best audio experience to listeners. Spotify is more than an audio streaming service - we are in the discovery business. We help make it easier to discover new audio that listeners love through personalized discovery at scale, around the world." While this shows their emphasis on audio streaming services, it also conveys that Spotify is always trying to achieve more so that they can better connect potential users with content creators, increasing the network effects of their company. With this being said, Spotify has a large target market. Spotify tries to reach all demographics, young and old, of those who like to listen to audio entertainment. With their many additions to their streaming services including music, podcasts, and more, Spotify hopes to cater to an even larger market and draw in more users.

Quantified Strategic Objectives

On top of their continuous innovation, Spotify seeks to experience continual growth in both the short and long terms. In their previous quarterly report, Spotify expected their growth metrics to look very favorable over the next year. In Q1 2024, monthly active users (MAUs) are expected to increase by a little under 3%, premium subscriptions by just over 1%, a 2.5% YoY revenue growth increase, better gross margins, and a significantly strong operating income that should shift from negative to significantly positive.[(4)] These numbers come after a particularly strong performance in 2023. MAUs and premium subscribers had just recently beat their previous growth estimates of 23% and 15% respectively, which has improved shareholder confidence in their newer markets of audiobook and podcast listeners. While this growth is expected to taper off after the first rush of new users from these newer focuses, their exposure to these new markets should help streamline growth.

Overall, Spotify is optimistic in their long-term growth rates. Since Spotify has long been a dominant player in the audio streaming industry, they have found new ways to innovate and align themselves with a larger demographic. Despite having just over 600 MAUs currently, they expect to hit 1 billion MAUs by 2030 [(5)]. While this goal may seem difficult to achieve, their innovation capabilities should help streamline this process in connecting audio producers to listeners. As long as Spotify can experience continual growth through the expansion of their audio streaming services, they should remain on schedule with reaching this goal.

Business Strategy

Spotify aims to support the creativity of artists and provide enjoyment and inspiration to fans by expanding its user base and enhancing the user experience. Spotify's strategy should highlight its strengths, utilizing their innovation of personalized content discovery and market presence to maintain its leadership in the music streaming industry. By focusing on product differentiation, targeted market expansion, and creator support Spotify plans to continue innovating with user features and diverse content offerings like podcasts and audiobooks. They aim to grow their user base and reach their goal of 1 billion active users by 2030 through expansion into emerging markets where music streaming is gaining popularity. Localizing content, adapting to subtleties, and utilizing collaborations to effectively enter these relatively untapped markets would be crucial.

In aiding creators, Spotify could create resources for access to monetization options, data analysis and promotional assistance. This move would empower musicians and podcast makers to excel on the platform aligning with Spotify's mission to support creative artists.

- Cost Leadership and Differentiation: While Spotify already offers a competitive price point, it aims to become a cost leader by optimizing royalty payment structures and reducing operational costs. Concurrently, it will employ a differentiation strategy by enhancing its unique features, such as personalized playlists, podcast integration, and exclusive content offerings.
- Market Segmentation: Spotify will target specific market segments, such as fitness enthusiasts, by integrating content-creating platforms. This would combine Spotify's music expertise with fitness routines, creating a unique product offering in the health and wellness sector.
- Technology and Content Investment: Continue investing in AI to improve the custom music and podcast recommendations to develop original content and reduce reliance on 3PL.
- Strategic Partnerships and Exclusivity: Expand relationships with artists and podcast creators to offer exclusive content, resulting in more users gearing towards the premium subscription tier.
- Global Expansion: Accelerate expansion into emerging markets with localized content and strategic partnerships to leverage regional growth opportunities.

Implementation Strategy

To better achieve the goals of their business strategy, Spotify should try to diversify their current offering in a related industry. They should plan an all-cash acquisition, which aligns with their business strategy of preferring acquisitions over methods, like solo ventures or alliances. Acquiring a firm allows Spotify to gain swift control in a new sector, diversify its content, and enhance its value proposition. This approach offers control and integration speed without the complexities of equity swaps or regulatory delays. With cash reserves and free cash flows, Spotify should be able to afford this acquisition without overleveraging or diluting shareholder value. Through this purchase, Spotify can quickly explore selling opportunities and integrate this new platform with its music and podcast services.

By acquiring companies in related industries, Spotify can achieve growth and diversification goals swiftly while integrating its services into its core offering. Specifically, Spotify should aim to achieve the following:

- Expand its user base efficiently.
- Merge and introduce new ideas utilizing newly acquired technologies that can complement its audio streaming services.
- Utilize shared data insights to enhance personalized user interactions and elevate the performance of platforms.
- Uphold its position as a market leader driving innovation in its sector and venturing into new avenues by leveraging the acquired skills and offerings.

Acquisition Plan

Plan Objectives

The Purpose of an acquisition is specifically to target a new segment of customers and bolster subscriptions in a new Market Segment. The acquisition should bring on a whole new set of users that will enjoy the synergies with the existing content Spotify offers. Access to these customers and providing them with a more connected distribution channel offers potential for growth in subscription fees and a platform that is more attractive to new users.

There should be several goals achieved with an acquisition, including:

- Cost reduction between the two merged companies in both operations and also content licensing
- Maintaining and increasing subscribers
- Merging the distribution channels or, at a minimum, offer well-connected synergies between the distribution platforms

Cost reductions in operations will occur through merged operating departments with reduced staff. These include the typical HR and business departments that overlap with similar jobs already being performed. There will also be an overlap with the information technology and app development teams especially as the distribution channels begin to merge. Cost reductions in the form of reduced licensing costs will be available. With an acquisition that brings on more subscribers, Spotify will have increased bargaining power with content generators (suppliers). The bargaining power will offer economies of scale and should reduce the fees associated with content licensing.

An acquisition should make sure not to alienate users, especially as the distribution channels begin to merge. The business that is acquired will have subscribers that utilize other music platforms (competitors to Spotify). Spotify should work with these customers to make it more attractive to abandon the competitor's music apps and switch to Spotify. Deals specific to the target's customers should be offered. These could come in the form of free trials, reduced membership fees or other perks. In addition, an advertising campaign should be initiated towards target customers to highlight any new synergies achieved and have insights on plans, functions, and upgrades that may come with the acquisition. A meticulously crafted plan will be put in place to merge the technological platforms, align branding strategies, synchronize content libraries, and unify corporate cultures. The plan will be created in the spotlight of maintaining and growing customers.

Timetable

The below-estimated timeline has been created to budget the costs and provide specific goals for completing the acquisition. The acquisition should occur as soon as possible to limits costs and start gaining revenues from the merger. Below is the proposed time schedule, with the groups involved and the estimated costs to complete. Most importantly the below table assigns a Champion or person in charge:

	Estimated Duration *(Months)*	Schedule		Groups Involved	Estimated Costs to Spotify		Champion
		Start Date	End Date		Internal	Consultants	
Initiation							
Search for Potential Targets	1	6/1/2024	7/1/2024	M&A Team, Corporate Search Consultant	$ 80,000.00	$ 100,000.00	M&A Team Lead
Select Specific Target	2	7/1/2024	8/30/2024	M&A Team, CEO, Finance Team, BOD, Corporate Search Consultant	$ 160,000.00	$ 500,000.00	M&A Team Lead
First Contact and Acceptance *(Estimated)*	2	8/30/2024	10/29/2024	CEO, M&A Team (Prep CEO)	$ 20,000.00		CEO
Negotiations		*10/29/2024*	*2/26/2025*				
Due diligence	2	10/29/2024	12/28/2024	M&A Team, Senior Manager of all departments, Legal and Finance teams	$ 240,000.00		M&A Team Lead
Refine Valuation	1	12/28/2024	1/27/2025	M&A Team, Finance Team	$ 40,000.00	$ 50,000.00	Finance Manager
Deal Structuring	1	1/27/2025	2/26/2025	M&A Team, CEO, BOD	$ 60,000.00		COO
Post Negotiation		*2/26/2025*	*6/11/2025*				
Financing Plan Development	0.5	2/26/2025	3/13/2025	M&A Team, Finance Team, Investment Bankers	$ 20,000.00	$ 150,000.00	Finance Manager
Integration Plan Development	1	3/13/2025	4/12/2025	M&A Team, CEO, COO, HR, Senior Managers	$ 40,000.00		COO
Regulatory Review *(Estimated)*	2	4/12/2025	6/11/2025	M&A Team, Legal Team	$ 80,000.00	$ 100,000.00	M&A Team Lead
Closing		*6/11/2025*	*7/27/2025*				
Prep Closing Documents	1	6/11/2025	7/11/2025	M&A Team, Legal, Finance	$ 80,000.00		M&A Team Lead
Signing date	1 day	7/27/2025	7/27/2025	CEO, M&A Team (Prep CEO)	$ 20,000.00		CEO
Post Closing		*7/27/2025*	*2/17/2027*				
Implementation Integration plan	18	7/27/2025	1/18/2027	CEO, Senior Managers from all departments, HR	$ 200,000.00		CEO
Review Integration Completion and KPI's	1	1/18/2027	2/17/2027	CEO, Senior Managers from all departments	$ 30,000.00		M&A Team Lead
				Total Costs	*$ 1,070,000.00*	*$ 900,000.00*	
				Total		**$ 1,970,000.00**	

There are several unknowns that are out of the M&A team's control: specifically regulatory review and acceptance from the target in which these lines are denoted by the term "estimated". It is important that other parts of the timeline are specifically tracked to keep a timely schedule and maintain momentum on the acquisition. The costs are estimated by using $240,000 average annual salary for the M&A team. Some tasks do not require the M&A team to be full time while others require time from senior managers, which should be accounted for in the costs of the acquisition. The Consultant fees include budgetary estimates for the following consultants:

- Outside Corporate search agency
- Outside legal consultants
- Investment banker services, including letter of intent (LOI)

Resource/Capabilities

Financial Resources:

Our group made an integration financial statement forecast for Spotify's income statement, balance sheet, and cash flow, forecasting Spotify's available cash. We estimated it to be 4,884.4M in FY24 and the free cash flow in FY24 to be around 1,500M. Operating cash flow is expected to improve year-over-year, maintaining investing and financing cash flow. Spotify's debt-to-capital ratio is 41% and its debt-to-EV ratio is 0.04, indicating that Spotify's issuance of debt for financing will not affect the financial health of the business.

Managerial Capability:

Daniel Ek, founder and CEO of Spotify, has been responsible for driving the vision and strategy of the company. Prior to founding Spotify in 2006, Ek had a resounding resume where he founded Advertigo and Tradera which were both bought out by larger conglomerates, one being eBay. Ek's expertise has allowed him to attract a very impressive board of directors who are very interconnected in both the M&A and growth space, setting them up well for acquisition.

Search Plan

In developing our search plan for Spotify, we recognize that Spotify is in a position where they have a strong grasp on the audio streaming industry. Spotify has innovated their audio product offerings extremely well to get to their current size, especially with their more recent expansion into podcasts, but have not taken much of a pivot beyond the audio atmosphere. Because of this, we feel that Spotify's most suitable target firms in an acquisition would allow them to diversify their offerings into an industry that can be complemented by their current audio streaming platform. In looking for a suitable target firm, we hope they meet the following criteria:

- Product offerings are complementary to audio streaming
- Integration of products/software can be relatively fluid
- Company utilizes a primarily online platform
- Operational and/or financial synergies can be achieved
- Acquisition offers potential to increase Spotify's audio streaming market
- Future cash flows and profits are expected to increase

With the following criteria, we can begin the physical search process. This will be conducted via online research of suitable industries that meet our needs. Once this is recognized, we plan on advertising to suitable firms via business press or any other means to display our interest. If need be, outside brokers may be utilized since they may help find a better fit. However, we would prefer not to take this route as it could lead to a costly acquisition down the line.

Implementation Plan

List of Potential Targets

Considering our search criteria, we found a suitable industry for our acquisition in the fitness industry, specifically companies with some type of virtual, online presence. Since most people like to listen to forms of audio entertainment while working out, we see this industry as a great complement to Spotify. Since both operate on online platforms, integrating services and software should not be too difficult and give way for potential synergies. Further, this industry has been growing quickly in recent years, which can spark better financial performance in the future and create a pipeline for more potential users on Spotify's current audio streaming platform. In refining our search to this industry, we considered the following companies: Peloton, Mirror, Echelon, and Soul Cycle (9). Given these options, Mirror and Echelon appeared as subpar alternatives to the other two. While relatively successful in their current states, these companies are significantly smaller and have not grown enough since their more recent inceptions. Due to their smaller presence and fewer users, they both would not yield a significant impact in creating additional value for Spotify.

Peloton and Soul Cycle both appeared to be suitable targets. Soul Cycle has been around for much longer than Peloton. While they have physical locations compared to Peloton's at-home workout machines, Soul Cycle has a very large community of users on their app. Our primary issue with Soul Cycle's model is that we are unsure of how their app can be completely integrated with audio streaming since workout classes occur in person, where music is typically played. Contrarily, Peloton's app is ideal for integration. Other than the necessary hardware for working out, everything is done via their app. They boast a large community of users that are very well connected—most of whom attend workout classes or listen to music via the Peloton app. This shows that Peloton's users are much more integrated with their app than Soul Cycle and would likely be more receptive to Spotify's newfound presence. We believe that with Peloton as our target, there is a greater likelihood of achieving synergies, meeting financial goals, and increasing monthly users. With Peloton as our target, we must consider any challenges that may occur in the deal. Peloton is in a completely different industry than Spotify. Considering their poor financial status and the fact that their industry isn't very highly concentrated, we do not foresee the possibility of any regulatory action being taken that could jeopardize a deal with Peloton.

Peloton's global footprint is limited to 5 countries, including the US. This limited footprint offers the potential for significant growth internationally since Spotify already has a foothold in over 230 countries [10]. Another growth opportunity is initiated by Peloton's workout classes, which do not require exercise equipment. Existing Spotify users will be targeted to try Peloton workouts to lure them into the Peloton world. Once a user is in the Peloton world of workouts, cross-selling efforts will begin to try and grow the equipment sales. Peloton offers a whole range of equipment and apparel that will be attractive to Spotify users who are just beginning to explore Peloton's offerings. Lastly, Peloton has an iterative user base. They have their favorite coaches and enjoy listening to the music selections played during their workouts. Spotify will gain additional user data for sales to music producers in an effort to sell concert tickets and promote new talent.

First Contact

Initial contact should be very strategic for Spotify especially considering the relationships that already exist between both Company's current management and board of directors. Spotify's board of directors consists of two important members who will be useful to approach and utilize for negotiation purposes. One of their directors, Barry McCarthy, is in fact the CEO of Peloton and was the CFO for Spotify from 2015 to 2020. McCarthy is already well-informed of the historical structure of Spotify and will be able to understand the financial synergistic opportunities that will arise from this merger. Spotify's lead director, Christopher Marshall, worked at a growth equity firm called Technology Crossover Ventures at the same time as Barry McCarthy and could also be a helpful asset to convince the transaction to go through. These two connections will make negotiation talks very discrete, which should help Peloton's concerns of being "put into play" and avoid any competing offers for Spotify to deal with. This strategy will help both sides achieve a friendly and mutually beneficial agreement.

Tactics

Spotify will approach this acquisition with specific instructions to make it a quick timeline. Spotify has a unique advantage, as we mentioned earlier, with their intertwined board of directors. This makes the tactic of a friendly acquisition beneficial for both parties as each will be able to benefit from a private deal. This will promote a smooth transition between both companies and allow for management to set in motion aspects among each business to give way to the combined entity. Spotify will also acquire Peloton for all cash due to its excess reserves along with Peloton's current debt structure. This cash purchase will give Spotify a great way to reinvest their capital and allow it to gain significant returns once synergies are realized from the combined entity.

Purchase (offer) Price Estimate

Refining Valuation

Peloton's profitability is poor, but its operating costs have been declining year-over-year and its operating income is gradually improving. Our overall valuation of Peloton is optimistic, with 4% revenue growth, their expected to be cash-flow positive over the next 6 years after turning around past overall losses, which could be further reduced if bankruptcy risk is considered. If bankruptcy risk is considered, the valuation could fall further, as Peloton has a large amount of debt causing their debt-to-capital ratios to be high and largely long-term. The industry average Debt to Capital ratio for Recreation is 33%, much lower than the Peloton's 127.2%. The high level of debt shows the high financial risk, which affects its market value, so market expectations for Peloton have been falling, which allows Spotify to acquire at a more lucrative price.

Free cash flow from 2024-2028

Free Cash Flow (FCFF)

	2024	2025	2026	2027	2028
Spotify *(Millions)*	$1,445.70	$1,964.40	$2,261.55	$2,715.27	$3,192.21
Peloton *(Millions)*	$85.71	$52.78	$122.19	$312.01	$512.62
Consolidated *(Millions)*	-	$2,041.62	$2,493.11	$3,184.11	$3,919.45

When we did the valuation, the price of Spotify was $300 and the price of Peloton was $3.55. The industry average acquisition premium is 31% for health care, but considering the terrible situation of Peloton, our lower offer price would be $3.99 per shares with 12.3% Acquisition premium, the Exchange ratio would be 0.01329. While we believe that a 12.3% premium is reasonable, we need to cap the offer at a higher premium of $4.26. This would be a higher range of our offer price, with a 20% Acquisition premium, and the Exchange Ratio would be .0142. The offer price range would be $3.99 to $4.26.

If the offer price is $3.99 per share, the Equity purchase value would be 1,451.3M. If the offer price is $4.26 per share, the Equity purchase price would be 1550.6M. Since Spotify has $4,884.4 Million cash in FY2024 we estimated, we could use all cash to process the acquisition.

	Low	High	Industry
Offer price	$3.99	$4.26	$4.65
Acquisition Premium	12.30%	20%	31%
Exchange Ratio	0.0133	0.0142	0.01550
Equity Purchase Value *(Million)*	$1,451.30	$1,550.60	$1,692.78

The present value of the synergies is $8,819.7million, making it well worth acquiring.

Negotiation and Deal Structuring

In Spotify's purchase of Peloton, there is no reason to change the corporate structure of the subsidiary or the parent company. If the post-merger structure remains as a corporation, they will have a continuity of ownership. In addition, this will continue to provide operation autonomy for the new combined entity. While there may be relatively high set-up costs for Spotify and double taxation on Peloton down the line, the merger can occur tax-free and promote operational efficiency in the future.

The deal structure will be a direct purchase of Peloton's equity. Spotify will present an all-cash offer, providing a clear, tax-efficient, and straightforward proposition to Peloton shareholders. This approach is preferred as it simplifies the negotiation process, provides immediate liquidity to Peloton shareholders, and avoids potential dilution or governance complications of issuing new Spotify stock. To close the valuation gap, Spotify can emphasize the strategic premiums and future growth potential that Peloton stands to gain, ensuring the offer is seen as beneficial and fair. For the merger structure, we recommend a Reverse Triangle Merger. The objective is to keep Peloton as a subsidiary and intact. With this method the firm does not have to dissolve and contract terms can be retained. It also prevents any acceleration of loan payments due to terms.

The financing method inevitably ties into the corporate structure. Spotify, operating as a C-Corp in the United States, retains the flexibility to leverage various financing instruments while navigating the tax and regulatory landscape. The acquisition's financing method should consider the implications on Spotify's ability to manage its increased debt load, potential changes in asset valuation, and the subsequent impact on its operational autonomy and flexibility.

The implications for corporate structure are profound, and the strategic use of these methods will influence the long-term success of the merger, affecting everything from day-to-day operations to broader strategic initiatives. As the two companies progress towards integration, a keen eye on maintaining financial flexibility and stakeholder value will be critical to realizing the full potential of this corporate conglomerate.

Financing Plan

As Spotify prepares to acquire Peloton, we're looking at a transformative opportunity to break into the dynamic fitness technology market. The deal is currently pegged at an enterprise value of $2.92 billion. With Peloton's revenue hitting $2.73 billion over the last 12 months, despite a period of heavy investment reflected by an adjusted EBITDA of negative $690.6 million, we're optimistic about the potential growth awaiting this merger.

Acquisition Funding: Our approach to funding this acquisition is using Spotify's strong free cash position from its operating activities, which for the last reported 12-month period was $735.4 million. Available cash for FY24 is $4.88 billion, the post transaction combined cash balance is $5.845 Billion. We aim to strategically manage Peloton's existing long-term liabilities, which stand at $2.34 billion, without compromising Spotify's strong financial base and debt servicing capabilities.

Valuation: We're basing our offer on a realistic evaluation of Peloton's recent performance, which, despite showing a net loss of $871.9 million in the trailing twelve months, is on a path of improvement. This is evident from the notable upswing in their EBITDA margin, which has improved from -41.85% in FY 2022 to -21.15% in FY 2023.

Synergies and Integration: By aligning Peloton's operations with ours, Revenue synergies are anticipated to increase 10% of Peloton's current total revenue, will arise from Spotify's existing user base and content curation capabilities, aligning with Peloton's 6.7 million connected fitness subscriptions as of the last 12-month data. An integral part of our acquisition strategy involves leveraging Peloton's tax positions, including net operating losses that could offset future taxable income to mitigate future taxable income, which is significant given Peloton's reported net loss. Our financial projections post-acquisition is conservative yet optimistic, with goals to bring Peloton to a break-even EBITDA within three years. This turnaround will be powered by Spotify's acumen in growing subscription-based revenues and optimizing costs. We're targeting a positive swing in Peloton's operational margins, aiming for a 10% operating margin in the upcoming five years. The post-merger revenue growth rate is forecasted to be 12.5% and Earnings Per Share is projected to be 4.14 in 2025. Considering that 2025 is the first year after the merger, there are new inputs and collaborations to be launched, the data estimate is conservative, and there are no large-scale layoffs, the actual synergies are expected to be better.

Capital and Resource Allocation: Spotify plans to allocate significant resources towards product innovation and technological infrastructure to support Peloton's growth, with a committed investment of up to $100 million in the first two years. To address any unforeseen challenges, particularly considering Peloton's past product recalls and legal issues, we'll set aside a $50 million contingency fund, ensuring financial stability during the integration phase.

Performance Tracking and KPIs: The success of the acquisition will be tracked against key metrics such as subscriber growth rate, average revenue per user (ARPU), and cost per acquisition (CPA), aiming for a 15%

increase in subscriber base year-over-year. The financial plan includes semi-annual reviews to adjust strategies based on market feedback and performance metrics. Our financial plan will undergo semi-annual reviews, enabling us to stay agile and responsive to both market trends and performance outcomes.

Integration Plan

The successful integration of Peloton with Spotify will be crucial to the ultimate success. The integration plan will be an active and open process. We hope to achieve the following:

- We plan to merge the strengths of Spotify and Peloton platforms to create an newly enhanced experience for all users. We will link Spotify's music library with Pelotons fitness features and while performing the transition we must ensure uninterrupted service.
- Our goal is to blend the cultures of both companies, fostering collaborative objectives setting and promoting open communication to establish a shared team culture. Encourage a culture through workshops, shared objectives and open communication channels to facilitate a smooth cultural blend.
- Our focus is on streamlining operations to lower costs and enhance performance by eliminating processes and optimizing efficiency while maintaining high quality products and services. Develop combined content strategies that make use of Spotify's expertise in playlists and Pelotons excellence in fitness programming.
- We are committed to complying with all regulatory requirements by seeking advice from experts to guarantee adherence. Identify redundancies and optimize processes to enhance efficiency post-merger while maintaining the quality of products and services.
- A key initiative is establishing a brand identity across Spotify and Peloton through a marketing strategy that emphasizes the advantages of combining both platforms and showcases the customer experience.
- Furthermore, cross-functional teams will be formed involving departments to oversee the integration process within budget constraints. Managing customer interactions and keeping them satisfied is crucial for retaining customers as the business undergoes changes. Developing a communication strategy to notify users about modifications and enhancements and valuing their input by acting based on their feedback.
- In addition, we aim to align processes, controls and reporting structures across both entities by integrating financial systems for accurate reporting in compliance with regulations.

Significant integration should be completed within one year of the merger. At that time, we will schedule a look back at the entire integration process to evaluate how well it was performed. Key metrics (KPIs) from a financial standpoint will be looked at in combination with the overall merger goals. If areas of the integration fell behind in the implementation of the goal or did not meet the KPIs, an action plan will be put together to address the issues. In addition, the company's cultural integration will be looked at in detail. Areas of concern will be highlighted, and an action plan will be developed to evaluate how the company's culture can be integrated further. This will include corporate messaging, one-on-one interaction/interviews, and surveys to see how the management can help facilitate the integration.

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Exhibit #1 – Key Financials

	Spotify	**Peloton**	**Consolidate**
Current Stock Price	$300.00	$3.55	-
Estimate value/share	$318.25	$3.32	$332.06
Share Outstanding *(Million)*	197.1M	364M	197.1M
Equity	$2,791.40	-$499.30	$2,292.10
Debt	$1,948.40	$2,334.80	$4,283.20
Capital	$4,739.80	$1,835.50	$6,575.30
Debt/Capital	41%	127%	65%
Enterprise Value *(Million)*	$55,162.80	$2,918.20	$65,449.43
Debt/EV	4%	73%	7%
Cash in FY2024 *(Million)*	$4,884.40	$961.10	$5,845.54
Revenue in FY2025 *(Million)*	$19,109.40	$3,029.70	$22,440.90
Revenue Growth	17%	4%	13%
Operating Income	$1,304.50	-$287.00	$1,025.50
EBITDA FY2023	-$275.50	-$690.60	-
Operating expense FY2025	-$4,046.10	-$1,680.20	-$5,857.60
Operating margin FY2025	6.83%	-9.48%	5%
EBITx FY2025	$36.02	-	$63.82
EPS FY2025	$5.56	-$0.68	$4.14

Exhibit #2 – Offer Price

	Low	**High**	**Industry**
Offer price	$3.99	$4.26	$4.65
Acquisition Premium	12.30%	20%	31%
Exchange Ratio	0.0133	0.0142	0.01550
Equity Purchase Value *(Million)*	$1,451.30	$1,550.60	$1,692.78

Exhibit #3 – Free Cash Flow