Q1 2022 Earnings Call
April 27, 2022

Prepared Remarks
Daniel Ek, Founder and CEO

Hi everyone and thanks for joining us.

I'll kick us off by sharing a few of the highlights you may have seen in our shareholder letter. We delivered another strong quarter in Q1 and when you exclude the impact of our withdrawal from Russia, we came in line or ahead on every metric. This performance builds on the momentum we saw in Q3 and Q4 of 2021 and I'm very pleased with the continued acceleration we are seeing in user growth headed into Q2.

There are puts and calls in every quarter and this one was no exception. As I've said several times before, Q1 traditionally sees lower new user activations, but despite this we delivered solid results. I think this is a testament of our consistency of execution and clearly shows just how compelling our offering remains for creators, users and advertisers – even in the face of uncertainty provoked by world events.

So it's safe to say that my overall confidence in the business continues to grow on all fronts. Case in point is the strength of our music business, evidenced by the recent release of new royalty data on our Loud&Clear website. The data clearly outlines the role Spotify and streaming are playing in growing the entire music ecosystem. Not only is streaming driving record revenues into the music industry, but there are more artists sharing in that success than ever before. In fact, the worldwide growth is truly staggering as more artists hit milestones across all revenue levels. For the first time, over 1,000 artists generated over $1 million and over 50,000 artists generated more than $10,000 on Spotify alone. For those who are interested in learning more, I would encourage you to check out the site.

So, our core business remains incredibly strong. This strength is built on the investments we continue to make in constantly enhancing our platform, which in turn, elevates the experience for users and creators. We are especially investing in our core platform capabilities. These are multi-year investments to enable a constant iteration across our products, tools and services — and given the positive results we are seeing, you should expect this to continue for the foreseeable future. I recognize that many of you want more clarity around when the benefits of all these investments will be realized including when they will show up in our financial statements. This is something we will unpack for you at our upcoming Investor Day.

But to give you a sense of the breadth and impact our investments are already having for creators, users and advertisers, allow me to offer a few examples of things we shipped this quarter.

Take our ads business, which continues to be a strong revenue driver thanks to the investments we are making to modernize audio advertising. Recent third party surveys validate this belief showing that Spotify is the “must-buy” audio ad partner in the US. We are delivering more impact for advertisers and publishers through acquisitions like Podsights and Chartable and we are already seeing the impact these moves are having on renewal rates and deal sizes. These moves will bring important innovation to the marketplace and accelerate our ability to unlock significant revenue growth in both music and podcasts.

At Spotify, we are constantly testing and experimenting and in Q1 alone, we ran almost 2,000 experiments, a 5% increase over the previous quarter. *S*ome of those experiments led to full global product launches, like the new updates and campaign we rolled out for Blend, which drove 17x more new user registrations than even our annual Wrapped campaign. In the first 20 days of the Blend campaign, we had 22M users create Blend playlists. And we are also seeing incredible user engagement worldwide with over 60% of streams coming from Gen Z listeners. These results are exactly the types of outcomes we aim to drive and we will continue to aggressively experiment with further user improvements.

Our podcast business also continues to surpass even our own high expectations with podcast share of overall consumption hours reaching another all-time record last quarter. We now have more than 4 million podcasts on our platform, up 53% year over year and up from 3.6 million last quarter with emerging markets in Latin America and Asia driving a lot of this growth. With more than 1,150 original and exclusive shows on our platform, overall podcast consumption is strong – and increasingly sticky – especially as we innovate with features like video, which more and more creators are taking advantage of as they seek to reach new global audiences and connect and interact with their fans in new ways.

With that, I’ll hand it over to Paul to go a little deeper into the numbers and then Bryan will open it up to Q&A.

Paul Vogel, Chief Financial Officer

Thanks Daniel, and thanks everyone for joining us.

While Daniel touched on most of our key KPIs, I wanted to add a bit of color on our operating performance, which was ahead of plan excluding the wind-down of our Russian business which started in March. Please note, Russia represented approximately 1% of our total MAU and subscribers and less than 1% of our revenues at the start of Q1.

Let me first start with MAU. On a reported basis, our total MAU grew to 422mn in Q1. It’s important to note that MAU did see an estimated 3mn benefit from a brief service outage that logged users out of Spotify, causing a portion of affected users to create new accounts to log back in. This had the effect of double-counting these users in the month of March. We saw this reverse in April as we cycled the 1 month anniversary of the outage. With that in mind, normalized MAU was approximately 419 million in the quarter, roughly 1 million ahead of plan. Our strength was led by strong results in Latin America and Rest of World, led by Indonesia, Brazil, and Mexico.

On the premium front, we reached 182mn subscribers in Q1. As we shared in early March, our exit from Russia led to 1.5mn disconnects in that market. Adjusting for that impact, net subscriber growth finished ahead of plan and was aided by outperformance in Latin America and Europe. We also continued to grow ARPU nicely in the quarter, which was up 6% Y/Y on a reported basis and 3% in constant currency.

Revenue finished slightly ahead of guidance. We had really great strength in advertising in the quarter at 30% growth, however it is important to note we were trending closer to mid 30% growth prior to Russia's invasion of Ukraine.

With respect to gross margin, Q1 finished modestly above plan at 25.2%. The modest beat was a few small differences vs. our forecast, nothing material to call out. Additionally, our core margins continue to improve while we invest aggressively against new initiatives.

Looking into the second quarter, we expect the remaining wind-down of our Russian business to reduce Q2 MAU by an incremental 5mn and subscribers by another 600k. Regardless, we are very encouraged by the trends we're seeing across the rest of the business and on a like-for-like basis, we see very healthy gains in Q2.

Excluding Russia and the MAU benefit caused by the March service outage referenced earlier, our guidance for 428mn MAU implies an increase of approximately 14mn net MAU, a healthy uptick in organic growth vs. the 9mn we reported last year and 13mn in Q2 2020. We continue to see promising growth in our largest developed markets, an ongoing rebound in developing markets like India and increasing traction in our 2021 market launches.

Our Q2 subscriber guidance of 187mn implies net adds of 6mn ex-Russia and reflects benefit from a one month global marketing campaign in the quarter.

Lastly, our outlook for a Q2 gross margin of 25.2% reflects our expectation for continued core operating improvement across our music and podcasting businesses, offset by select growth initiatives. As a reminder in Q2 2021, Gross Margins had a one time benefit of 200 bps due to the release of accruals for prior period publishing royalty estimates.

As discussed on the Q4 earnings call, we continue to see a number of opportunities for investment. In light of the positive results we're seeing and the attractive long-term potential of these investments, we will continue to pursue many of these initiatives this calendar year. As a result, we expect to keep gross margins around Q1 levels throughout the balance of 2022. And while we aren't providing guidance beyond Q2, our current expectation for next year would be a continued upward momentum in our core business and a smaller drag from new investments.

Finally, I wanted to conclude with an update on our upcoming investor day. We look forward to updating you on the progress we've made since our direct listing; sharing details about our roadmap; and providing clarity on the financial progression we expect over the intermediate and long term. We are still finalizing plans for our 2nd ever Investor Day – stay tuned for more info about timing, speakers, and everything else, in the next few weeks.

With that, I'll hand things back to Bryan for Q&A.

[Q&A Session]

Daniel Ek

Thank you all for joining the call. I look forward to sharing more at our upcoming Investor Day.

In the meantime, we will share more about the quarter on our For the Record podcast so I hope you will tune in.