Spotify

Q2 2023 Earnings Call Prepared Remarks

July 25, 2023

Bryan Goldberg, Head of Investor Relations

Thanks operator and welcome to Spotify's Second Quarter 2023 Earnings Conference Call. Joining us today will be Daniel Ek, our CEO, and Paul Vogel, our CFO. We'll start with opening comments from Daniel and Paul and afterwards we'll be happy to answer your questions.

Questions can be submitted by going to slido.com and using the code #SpotifyEarningsQ223. Analysts can ask questions directly into Slido and all participants can then vote on the questions they find the most relevant. We ask that you try to limit yourself to 1 to 2 questions, and, to the extent you've got follow ups, we'll be happy to address them, time permitting.

If for some reason you don't have access to slido, you can email investor relations at ir@spotify.com and we'll add in your question.

Before we begin, let me quickly cover the Safe Harbor. During this call, we'll be making certain forward-looking statements including projections or estimates about the future performance of the Company. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of factors discussed on today's call, in our Letter to Shareholders and in filings with the Securities and Exchange Commission.

During this call, we'll also refer to certain non-IFRS financial measures. Reconciliations between our IFRS and non-IFRS financial measures can be found in our Shareholder Deck, in the financial section of our Investor Relations website and also furnished today on Form 6-K.

And with that, I'll turn it over to Daniel.

Daniel Ek, Founder and Chief Executive Officer

Hey everyone. Thanks for joining us.

I hope you all had a chance to review our shareholder deck. As you can see, it was a very strong quarter. We beat our own expectations, again, across both MAUs and Subs. In addition, it is gratifying to see that the outperformance in growth is continuing to come from markets all over the world.

Let me share some more context on the growth this quarter before we go into what it ultimately means for the business. This quarter netted the highest MAU growth in Spotify's history. As a point of comparison, our growth this quarter was 36 million - compared to Q2 of 2022, where we saw MAU growth of 19 million. This reacceleration is significant and shows that our investments in adding podcasts and improving our platform and user experience are paying off nicely.

I have talked before about the fact that the biggest driver of our subscriber growth comes from users who start on our ad-supported service. It's a powerful funnel, where the more our users discover and engage, the more they're willing to pay for an enhanced experience. With six quarters of MAU outperformance, we are capitalizing on this momentum and it's proving to have a meaningful effect – helping us achieve 10 million net new subscribers this quarter. *Three* million more than we originally anticipated.

Now, let's talk about revenue growth. There are three ways for us to drive revenue growth: growing our users, creating new businesses with new revenue streams, and increasing revenue per user. Our preference among them is to focus on growing the overall number of consumers on our platform, as this gives us scale advantages and retains optionality for the future. However, we've also been clear that there will come a time when price increases become a more important tool in the toolbox.

To that end, as most are aware, yesterday we announced broad price increases across more than 50 markets, including most of Europe and North America. We've carefully weighed this decision but felt the timing was right. We've expanded value to price significantly by meaningfully improving our content offering, and we continue to enhance the user experience and lower churn. And over the past few years, we have learned a lot as we have conducted over fifty price increases. This experience coupled with our strong offering, puts Spotify in an excellent position to make this move. While this won't impact revenue per user much until the end of Q3, we expect it to have a meaningful impact on Q4 and beyond.

Finally, we continue to make progress on improving efficiency across the company. As Paul will explain, we have taken several actions to further streamline our operations and reduce costs, which we largely outlined in Q1. These moves position us to become a much stronger business in the future.

Despite making these changes in an effort to create more efficiency, we have still managed to increase the overall velocity of experiments and new improvements. This gives me a lot of confidence. Looking back at Spotify, the lesson we have learned is that daily progress, even if faint, is more important than the occasional clash of brilliance we have had. Therefore, I believe that the speed of iteration is perhaps the ultimate leading indicator of our long-term success.

With that, I'll turn it over to Paul for more detail behind 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. I'd like to add a bit more color on the quarter and then touch upon the broader performance of the business and our outlook.

Overall, our User and Subscriber growth was exceptionally strong in the quarter. Users grew by 36 million to 551 million while we added 10 million new Subscribers finishing at 220 million. Both MAU and Subscriber growth accelerated from Q1, driving the highest quarterly User growth in our history and the best Q2 for Subscribers on record.

On the Revenue front, we grew 11% Y/Y to €3.2 billion during the quarter. Our FX neutral growth was 14% and accelerated vs. the prior quarter's result.

Let me turn now to Gross Margin. As I previewed during the Q1 call, we expected to incur charges in Q2 related to our ongoing efficiency efforts. In the quarter, we took steps to shrink our real estate footprint and rationalized certain areas of our podcasting business. We also exited our Soundtrap marketplace business. We expect all of these moves to have a positive impact on our rate of profitability on a go forward basis, however they did result in roughly €135 million of net charges in the quarter, with €44 million flowing through Gross Margin and €91 million flowing through our Operating Expenses. About €25 million of these charges were cash-related.

With that context, Adjusted Gross Margin (which excludes all charges) was 25.5% and in-line with expectations. As a reminder, we guided to Gross Margin excluding potential one time charges. Adjusted Operating Loss of (€112) million was better than planned, helped by lower marketing and legal spend, which more than offset higher than anticipated Social Charge accruals.

Free Cash Flow was positive €9 million in Q2.

Looking ahead to third quarter guidance, we are forecasting 572 million MAU, an increase of 21 million from Q2 and 224 million Subscribers, an increase of 4 million over Q2. We are also forecasting €3.3 billion in Total Revenue, a Gross Margin of 26% and an Operating Loss of approximately €45 million.

First, looking at user and subscriber growth, we have had an outstanding start to the year and we see momentum continuing into the back half of the year. And to address a likely question right up front with respect to price increases and subscriber growth…our data would suggest that historical price increases have had minimal impact on growth, but given the breadth of this change and the significant outperformance in the first half of the year, there is some conservatism baked into our outlook for Q3. We do expect our net adds through Q3 of this year to be higher than at the same point last year…roughly 30% better (or 13% ex Russia impact).

Turning to Revenue, we are forecasting a 600 bp headwind to growth given the continued strengthening of the euro relative to the dollar and those trends appear to be continuing into Q3. Excluding this effect, our constant currency Revenue would be closer to €3.5 billion, reflecting our expectation for accelerating currency neutral growth to 16%Y/Y vs. the 14% growth we delivered in Q2. We anticipate further revenue growth acceleration in Q4 relative to Q3 on a currency neutral basis due to a full quarter benefit from price increases. For clarity, the recently announced price increase will have a small impact on Q3 revenue given billing cycles and timing. Q4 will get a full quarter benefit and therefore the greater impact on accelerating revenue.

From a profitability standpoint, we continue to expect a sequential ramp in Gross Margins through the balance of 2023 as well as improvements in our Operating Loss.

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

Bryan Goldberg

Thanks Paul. Again, if you have any questions, please go to Slido.com, #SpotifyEarningsQ223. We'll be reading the questions in the order they appear in the queue, with respect to how people vote up their preference for questions.

[Q&A]

Bryan Goldberg

That's going to conclude the Q&A section of our call, and now I'm going to turn it back to Daniel for some closing remarks.

Daniel Ek

Thanks, Bryan.

It was a great – and historic – quarter for Spotify, and I am energized by our growth and continued outperformance. The price increases we announced yesterday demonstrate the value we provide to our customers and the strength of our offering. As a team, we are moving faster than ever, and we are better positioned to deliver on our potential and the ambitions we laid out for you at last year's Investor Day. We are making tremendous progress toward those goals, and I feel confident about our momentum heading into the second half of 2023.

Thank you for joining us, and as usual, feel free to check out our For the Record podcast, which will be released later today.

Bryan Goldberg

Ok, and that concludes today's call. A replay of the call will be available on our website and also on the Spotify app under "Spotify Earnings Call Replays". Thanks everyone for joining.

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