# Q3 2022 Earnings Call Prepared Remarks
## October 25, 2022

**Bryan Goldberg, Head of Investor Relations**

Thanks operator and welcome to Spotify's Third Quarter 2022 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 (S L I D O.com) and using the code #SpotifyEarningsQ322. 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 Letter to Shareholders, 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 CEO**

Hey everyone, and thanks for joining us.

I hope you had time to review our results. As you can see, it was another solid quarter. User growth and subscriber growth keeps humming along very steadily. I have said it before, but it can't be understated. Topline growth in the platform is the leading indicator for future success on all other financial metrics.

But I want to start by addressing the macro environment, which I know is top of mind. There is a lot of global uncertainty. But for Spotify, our business continues to perform very nicely around the world. Outside ads, we aren't seeing much impact at all, and the ads business is still growing and will be important – but remains a relatively small portion of our overall revenue today.

If you recall, at our Investor Day in June, I said that I suspect many of you think Spotify is a great product. Yet at the same time, you may also think we are a bad business - or at least a business with bad margins for the foreseeable future.

Our Q3 results clearly show that our investments in the product and experience have resulted in strong user growth, retention and increased engagement. But they've also been a drag on near term margins.

Just to remind everyone, this is all consistent with the strategic decisions we communicated in early 2021 and again at Investor Day. And as we've said, we expect this drag on margins will start to reverse in 2023.

As I also shared at Investor Day, LTV – the lifetime value of a user – is the primary tool we use to inform our business decisions and judge whether our strategy and investments are working and achieving better outcomes. And the beauty of LTV is that it factors in the longevity, quality, and value of the relationship we have with a user. It is a critical metric to all teams at Spotify.

We are constantly experimenting with what leads our users to *stay longer*, *engage* more deeply, and ultimately, *convert* to our paid offerings. And what we've seen time and again is how sticky our users are because of the product and experience we've created. I believe we have the lowest churn across our competitive set because of the many ways we keep listeners engaged and happy – and therefore retained. And because of the strength of this relationship, we know that spending to acquire new users is a worthwhile investment that over time, will have a meaningful return.

So here is how we think about it….This trade-off is worth making IF our actions result in an increase of Life Time Value of a user <u>and</u> we also maintain a healthy customer acquisition cost to LTV.

But I also want to reiterate that we are <u>keenly</u> aware that this is an uncertain time and the cost of capital has increased. So inevitably, you should expect our hurdle rate for new investments to be higher…And consequently, you should also take this to mean that we will be more selective with our overall spending moving forward.

We will make new investments with two key criteria in mind: First, it must be accretive to margin (over the investment period) given this new hurdle rate…. and second, over the long term, that investment must strengthen our value proposition to users and creators alike.

That said, new opportunities will likely emerge in a downturn. As an example, we may find that our Customer Acquisition Cost goes down as the cost of advertising typically declines in a softer market. This would then offer us a clear opportunity to grow our market share even in a challenging economy because we can acquire users at a lower cost relative to LTV. We saw this dynamic play out at the beginning of the pandemic and benefited from it. And we expect we would do so this time around, should the opportunity present itself.

This philosophy is not new for those that have followed us for a while. But I realize that this may frustrate some of you who would prefer we manage to the quarter. Some companies do just that and I get that's what some investors look for. Especially in this "show me market."

But simply put, I don't think that's a winning strategy long term, nor is it the right one for Spotify. We've been transparent that 2022 was going to be an investment year, which would result in a drag on our gross margin in the short term. This quarter is case in point. But it shouldn't come as a surprise. Nothing has changed with our fundamentals. Our business is strong. We are heading into 2023 with more cost certainty, stronger product, and a better user position so this is all playing out largely as we expected despite the macroenvironment.

Our confidence in our ability to meet our long-term goals and the ambitions we laid out at Investor Day remains unchanged. And based on the strong demand for our platform amongst consumers and creators this quarter, I believe we will deliver.

With that, I'll hand it over to Paul to go 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.

I'd like to add a bit more color on our operating performance and highlight what we're seeing with respect to the macro environment and then touch upon our outlook.

Q3 OPERATING PERFORMANCE

Starting with our strong user performance. Total Monthly Active Users grew to 456 million in Q3. This was the largest Q3 net additions in our history and excluding our exit from Russia, our year to date net additions are at a record high and we expect this to sustain through year-end.

Moving to Premium, we finished the quarter with 195 million Subscribers – 1 million ahead of guidance – thanks to broad-based strength across regions, particularly in LATAM.

Our Revenue grew 21% Y/Y to just over €3 billion in the quarter. This was slightly ahead of guidance, driven mostly by foreign exchange.

Our Advertising business grew 19% Y/Y and was led by strong double digit gains in our podcasting business. While this overall result was a bit below our expectations, we continue to see encouraging signs that our ad strategy is working - despite some of the near term macro headwinds - particularly the continued increased interest in SPAN.

Turning to Gross Margin. Gross Margin of 24.7% was below guidance by 50 bp. There are 3 factors that contributed to the result. In order of significance

- First, the expected renewal of a large publishing contract outside the US resulted in an accrual adjustment this quarter. The adjustment reflected revised estimates spanning the previous 9 quarters. While the amounts were immaterial in any single quarter, taken together, they added up to a material impact to Q3.

- Second, like many, we did experience some impact to top line advertising growth from the macro slowdown and this shortfall had a modest impact on margin,

- Third, currency fluctuations—mainly the continued strength in the US dollar—had a small impact on cost of revenue. Historically, currency has had a big impact on operating expense, and a somewhat minimal impact on cost of revenue. However, given the significant strength of the dollar, it has started to impact gross margin as well.

Taking a step back, we don't see anything in the results that changes our view of the margin potential we laid out at investor day.

Importantly, we view the publishing renewal in this quarter—along with the recent proposed settlement related to the US CRB on Phonorecords 4 rates—as very positive developments. They offer greater cost visibility and taken together, these two deals are consistent with the profitability targets we communicated to you at our Investor Day.

Looking at Operating Expenses, growth in the quarter was slightly lower than forecast on a currency neutral basis, however currency fluctuations proved greater than planned. When combined with our modest variance in Gross Profit, our Operating Loss was slightly below guidance. Currency continues to be a big impact - adding €85 million to operating expenses or just over 14 percentage points of year over year growth.

Touching on Free Cash Flow, we generated our 10th straight quarter of positive Free Cash Flow. We continue to generate roughly €200mn in Free Cash Flow on a trailing 12 month basis. Given the timing within quarters, we may see free cash flow turn negative in Q4, but we still expect to be free cash flow positive for the year and moving forward.

OUTLOOK

Looking at Q4 and beyond…as Daniel said, we continue to monitor the global macro environment and to-date have seen no material impact outside of our ads business. When we began 2022 we stated that we expected to see MAU and Subscriber net additions grow at roughly similar levels to 2021. As we enter the fourth quarter, we now expect MAU net additions to finish materially higher by year end and we see subscriber growth roughly in line with those expectations, excluding the impact of Russia. With respect to Q4 ARPU, we expect it to be up mid single digits on an as reported basis.

On the advertising front, we are seeing some modest improvement from where we were a month or two ago but the macro environment still has a reasonable amount of uncertainty . As such, we expect another quarter of decelerating growth in Q4…but continue to remain confident in the long-term potential of the business.

Our Gross Margin outlook for Q4 is 24.5%. We recognize this is likely a bit below what many of you had been expecting based on our commentary exiting our Q1 results for a Gross Margin of around 25% for the balance of the year. The variance between these figures is primarily a result of three factors - including the softening macro environment over the course of the year which is reflected in the current advertising slowdown. We also see another quarter of negative currency exposure. Last, Q4 includes restructuring charges at our podcasting business which should lead to improved productivity at select studios on a go forward basis. All-in, we anticipate approximately 70 basis points of impact from these three items, with the impact spread roughly evenly across each.

In closing, despite an uncertain macroeconomic environment, we continue to be highly encouraged by the overall trends we have seen year to date. We laid out a vision for our business model expansion at our investor day which we still firmly believe we will execute against. This year has been one of investment, hitting both gross margin and operating expenses and while it is too early to provide any guidance with respect to 2023, we do expect our profitability rates to improve relative to 2022 as we grow revenue, lap certain investments and deploy capital efficiently.

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

**Bryan Goldberg, Head of Investor Relations**
Thanks Paul. Again, if you have any questions, please go to Slido.com, #SpotifyEarningsQ322. Once your question is entered, you can edit or withdraw it by selecting the option in the bottom right. 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.

**[INVESTOR Q&As]**

**Daniel Ek, Founder and CEO**
Thank you all for joining the call. I'll close by saying that with one quarter left in a year that has seen war, a lingering pandemic, inflation, supply chain disruption, and threats of a global recession, I am really proud of all that we have accomplished and that despite all of this, we are precisely where we thought we'd be.

While there may be more roadblocks than there were in the past, we remain incredibly confident in the course we've charted and in the destination we've mapped out for ourselves. We will be more nimble and more prudent as the times demand. For more detail, check out our For the Record podcast dropping later this evening.

**Bryan Goldberg, Head of Investor Relations**

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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