

Paraphrase of

Spotify's Numbers Show Growth, and Maybe a Path to Profits

Spotify is continuously increasing its size and reach, working on spreading to new countries, gaining new customers, and retaining current users. Because of its focus on growth, however, it is difficult to say when the company will begin to turn a profit.

Recently stepping onto the stage of the New York Stock Exchange, Wall Street is keeping an eye on the unusual company and its direct listing. Although Spotify is not a new company, having started in 2008, it has not reported net profit in any year since its founding. Spotify is certain that its focus on growth rather than profit will make it even more profitable in the future than if they had focused on turning a profit earlier. Focusing on the growth of a company is almost always expensive, but it's clear that Spotify is creating more profit as time continues.

Free cash flow, a measurement that some investors use to determine the level of performance of a company, finally moved into the positive last year, with Spotify generating €109 million (\$134.7 million) in free cash flow just in 2017. Since 2016, Spotify has been slowly moving towards the black in terms of their free cash flow.

In March of 2018, Spotify predicted that in 2018 the expected revenue was to increase as much as 30% and an increase of Spotify Premium users by as much as 36% year-over-year. While this signals a large increase of growth, it is less than what Spotify has seen in the past.

The Consumer Technology Association predicts that the U.S. consumer spending for music-streaming services like Spotify is probably going to jump 29% to \$6.6 billion in 2018. This means that Spotify is not only on top of its competition, but it's on top of its competition in a market that is only expanding. In the music-streaming industry, a popular measurement for the different services is the number of subscriptions, which create on average more revenue than services that rely on ads to create profit.

With 157 million monthly active users in 61 countries, Spotify claims that 71 million of its users are within the premium paid subscription category. They believe this to be close to twice the amount of Apple Music, their closest rival. Spotify did not disclose how many of those 71 million subscribers are using a free trial, while Apple Music does not include trial users in its

reported total subscription number. Because of the discrepancy in the reporting of the number of subscribers, the gap between Spotify and Apple Music is smaller than we may think.

Eddy Cue, the services chief at Apple, said in March of 2018 that Apple Music has 38 million subscribers in addition to eight million users that were in a free trial. While Spotify will allow users to listen to their music without paying indefinitely, including ads between songs, Apple Music forces users to switch over to a paid subscription after the trial period ends.

Spotify expects 92 million to 96 million premium subscribers by the end of 2018, marking its growth between 30% and 35%. While this is substantial growth, it is less than the 46% year-over-year increase they expected in 2016 and 2017. The number of subscribers is still going up, although not as quickly as initially thought.

Subscriptions contribute 90% of the total revenue for Spotify, with the free trial and ad memberships leading users into the paid subscriptions. It claims that as more users of the free subscriptions use and interact with Spotify, more are likely to invest in a paid subscription plan. In December of 2017, Spotify said that 50% of the monthly active users become premium subscription holders within three years.

The amount of users with paid subscriptions was just 31% in 2015, and grew to 44% in 2017, although the amount of revenue from each user has decreased, from €7.06 in 2015 to €5.24 a month in the last quarter of 2017. This decrease in revenue per user is due to customer discounts like family and student plans that aim to keep subscribers and help gain new ones with lower prices. The amount of subscribers who end their subscriptions went down from 7.5% in 2015, to 6% in 2016, and 5.1% at the end of 2017.

Due to the set-up of Spotify, they have to pay royalties to record companies and producers every time a song is played, rather than Netflix's set up where they pay one upfront fee to the right to put the movie or show on their website. This set-up makes it harder to make a profit through Spotify, causing costs to rise closely to profits. Although we do not know the rate of the royalties or the subscriber targets, we know that Spotify has an agreement with record companies saying that as Spotify grows and reaches a certain number of subscribers, the rate for the royalties will lower. This will eventually make it easier for Spotify to make a profit,

although we cannot know how close that is.

Barry McCarthy, who worked for Netflix previously, said at a Spotify investor presentation that they plan on staying on top of their industry, believing that with longer subscription users, they will become more profitable in the future.

In March of 2018, Spotify predicted margins from 23% to 25%, an increase from 2017's 21% and 2016's 14%. Spotify's revenue is anticipated to range from €4.9 billion to €5.3 billion from 2017's €4.09 billion.¹

¹ Anne Steele, "Spotify's Numbers Show Growth, and Maybe a Path to Profits," *Wall Street Journal*, March 26, 2018, sec. Tech, <https://www.wsj.com/articles/spotify-numbers-show-growth-and-maybe-a-path-to-profits-1522058400>.