Q4 2024 Earnings Call

Company Participants

- Alex Norstrom, Co-President, Chief Business Officer
- Bryan Goldberg, Head of Investor Relations
- Christian Luiga, Chief Financial Officer
- Daniel Ek, Founder, Chief Executive Officer and Chairman
- Gustav Soderstrom, Co-President, Chief Product and Technology Officer

Presentation

Operator

Good morning and welcome to Spotify's Fourth Quarter 2024 Earnings Call and Webcast. All participants are in a listen-only mode. (Operator Instructions). As a reminder, this conference call is being recorded.

I would now like to turn the call over to Bryan Goldberg, Head of Investor Relations. Thank you. Please go ahead.

Bryan Goldberg {BIO 22029069 <GO>}

All right. Thanks, operator, and welcome to Spotify's Fourth Quarter 2024 Earnings conference Call. Joining us today will be Daniel Ek our CEO; Alex Norstrom, our Co-President and Chief Business Officer; Gustav Soderstrom, our Co-President and Chief Product and Technology Officer; and Christian Luiga, our Chief Financial Officer. We'll start with opening comments from the team and afterwards, we'll be happy to answer your questions. Questions can be submitted by going to slido.com and using the code #SpotifyEarningsQ424. Analysts can ask questions directly into Slido and all participants can then vote on the questions they find the most relevant. 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 shareholder deck, 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 {BIO 16541022 <GO>}

All right. Thanks, Bryan. Hey, everyone, and thank you for joining us. I wanted to start by speaking to the devastation caused by the LA fires. LA is home to hundreds of Spotify employees, millions of music fans and countless members across the creative industries. We've committed our financial support to recovery efforts and we'll continue to look for ways to help those impacted.

And before turning to the quarter, I wanted to introduce Chief Business Officer, Alex Norstrom and Chief Product and Technology Officer, Gustav Soderstrom. Since they've been elevated to the role of Co-Presidents in January 2023, they've been leading much of the day-to-day operations at Spotify. And this has allowed me to spend more time working on the future of Spotify, which is where I've always believed I can have the biggest impact and we'll aim to bring Alex and Gustav to future calls to share their perspectives on our goals and performance.

So moving to our performance. We had a strong quarter and closed out 2024 even better than we anticipated. This gives us plenty of runway and flexibility for years to come. It was our highest Q4 ever for MAU additions and our second-highest of all time. We also had record-high subscriber additions, but that's not all. We set quarterly record highs for revenue, gross margin, operating income, and free cash flow as we closed out our first full year of profitability. So what drove this growth? Well, in large part, it's the result of countless improvements and tweaks we made over the past two years and continuous system of innovation that has brought us to where we are today.

In Q4, we enhanced our product in areas like video and audiobooks with many more innovations to come in the quarters ahead. And it's really this ongoing commitment to incremental progress that ultimately adds up to something massive over the long term, even if the exact timing sometimes is hard to predict. Gustav, do you want to share a few thoughts on how we innovated the product given how consequential it's been for our growth?

Gustav Soderstrom {BIO 20561192 <GO>}

Sure. Thanks, Daniel. So as you shared, we made some exciting updates this quarter, including launching our new video proposition at scale. But beyond the work itself, I also want to commend the team for how quickly we got it done. For example, when we saw higher engagement happening on video podcasts and received feedback from creators that they were looking for new monetization opportunities, we moved really fast to launch our new Spotify partner program and video podcast experience.

And video podcasts are seeing enormous spikes in popularity on Spotify, and we now have more than 330,000 video podcasts globally. And even more, over 270 million users have Stream One. And during a creator event that we held in LA last November, we announced that we are now giving premium users the ability to watch their favorite podcast uninterrupted by dynamic ads. And we also introduced new efforts and tools to help video creators turn their shows into a sustainable business. And in just the first couple of months actually, more than 70% of eligible shows and networks have already enrolled. We're incredibly pleased with these early results and we will continue to innovate from here.

Daniel Ek {BIO 16541022 <GO>}

Great. Well, okay. Thanks, Gustav. Another huge driver behind our MAU and subscriber growth was our annual wrapped campaign, which celebrated 10 years. Wrapped is always a big contributor to our Q4 performance and this year was no exception. Alex, perhaps you want to share a bit more light on what happened in the campaign.

Alex Norstrom {BIO 19813860 <GO>}

Happy to, Daniel. Wrapped is a massive cultural moment for Spotify, but it's also become a significant driver of our business. This year, over 245 million users engaged with Wrapped, surpassing 2023's record within the first seven days of the campaign. And importantly, we saw impressive engagement in key growth markets like Brazil and Indonesia. Every year, it's just wild to see how deeply our users care about their own personalized Wrapped experience. And because it's become such a phenomenon, it also means that there's a ton of visibility. We did change up the experience a bit and despite the massive success in the engagement, we heard from a few users that they wanted to see more -- even more creativity. So look for more surprises from us in our 2025 experience. But overall, a really big win as evidenced in our numbers.

Daniel Ek {BIO 16541022 <GO>}

All right. Thanks, Alex. So as you can see, many of the things we put in play are working very, very well. And 2024 was a year where we really showed what we're capable of. And I'm sure you must be asking, if 2024 was the year of monetization, how will we define 2025? Well, I'm still working it through, I am coining this year the year of accelerated execution. So what does this look like in practice? Well, I think it will require three things. First, we need to move even faster to ship improvements. The landscape is shifting constantly and I want to set the pace, not play, follow the leader. We're also going all-in on our core and investing in more music experiences on the platform. Think video, think the higher priced premium tier that we've discussed previously, and new ways to bring fans and artists closer together, features and offers that will all continue to push the historic expansion we're seeing in the music industry. And finally, we must also remain disciplined with our resources as we aggressively pursue these opportunities.

I will let Christian talk more about the forecast, but as you look at Q1, remember that there's always a little overhang that we see in this quarter, a quarter that historically looks different than the rest of the year. And while we don't share an annual forecast, I couldn't be more confident in where we're headed and I expect 2025 to deliver healthy growth alongside improved profitability. And we're doing all of this while we continue to learn and optimize investing for the long-term to benefit of artists, creators, and our users.

With that, I'll turn it over to Christian.

Christian Luiga

Thanks, Daniel, and thanks to everyone for joining us. Let me give you some color on the quarter four results and then some perspective on our outlook. Our quarter four was exceptionally strong. MAU grew by 35 million to 675 million in total. We added 11 million net subscribers, finishing at 263 million. This represented our best quarter four for MAU net additions, while the net additions for subscriber matched the peak performance we delivered five years ago. Total revenue was EUR4.2 billion and grew 17% year-on-year on a constant currency basis. Premium revenue rose 19% year-on-year on a constant currency basis, driven by continued subscriber growth and ARPU growth associated with price increases. Our advertising business saw currency neutral growth of 6%, reflecting market spending and brand-related campaigns. We also saw some early positive progress in our automated sales efforts.

Moving to profitability, gross margin came in at a record 32.2%, surpassing guidance by approximately 40 basis points, primarily due to content cost favorability. For the full year, gross margin came in at 30.1%, representing 450 basis points of improvement relative to the full year 2023. This was our largest rate of gross margin expansion as a public company. Operating income of EUR477 million was aided by gross profit strength. Operating income was impacted by EUR96 million in social charges in the quarter, which were EUR80 million higher than our forecast. As a reminder, we don't forecast share price movements in our outlook for the business since they are outside of control.

Finally, free cash flow was record EUR877 million in the quarter. Performance here was driven by our improved operating income profile as well as the net working capital favorability. We ended the year with EUR7.5 billion in cash and short-term investments. So looking ahead to guidance, as many of you know, we are entering a seasonally smallest quarter in terms of MAU and subscriber intake as well as ad sales. As a result, in quarter one, we are forecasting 678 million MAU, an increase of 3 million from quarter four, and 265 million subscribers, an increase of 2 million over quarter four. We're also forecasting EUR4.2 billion in total revenue. We anticipate a gross margin of 31.5% and an operating income of EUR548 million.

With respect to the MAU net additions, we had an exceptionally strong quarter four with outperformance driven by developing markets, and we are not prioritizing retention of the recent influx of lower engagement users in quarter one as we continue to focus on growing higher value users. While this will amplify typical quarter-one seasonality, for the coming quarters we remain confident in our product and marketing strategies and we expect full-year 2025 net additions to be within the range of the last four years. We respect to -- with respect to subscriber net additions, we expect another year of healthy growth with a focus on customer quality and improving LTVs. While we do not give full-year guidance for gross margin and operating margin, we are expecting both to improve in 2025 on a full-year basis, albeit at a more moderated pace relative to last year's exceptional levels. As Daniel alluded to earlier, we plan to make targeted investments in our core offerings, which may make our sequential gross margin cadence a bit more variable over the course of this year. That said, our fourth quarter gross margin is expected to be higher than the quarter one due to seasonality.

Finally, we expect our free cash flow generation to meaningfully exceed what we generated in 2024. On capital allocation having just generated our first year of profitability, we're very pleased with the recent inflection in our liquidity profile and emerging optionality this provides. Sustainable growth opportunities with attractive return potential remains our top priority. We are prioritizing the business first. To the extent capacity rises, we will, of course, take our shareholders into consideration. In conclusion and echoing Daniel's remarks, in 2025, we expect healthy growth and continued improvements in profitability, while remaining disciplined with our resources.

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

Questions And Answers

A - Bryan Goldberg {BIO 22029069 <GO>}

Great. Thanks, Christian. Again, if you've got any questions, please go to slido.com #SpotifyEarningsQ424. 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. And today's first question is going to come from Doug Anmuth on 2025 framing. 2022 was an investment year for Spotify, 2023 was about efficiency, 2024 was monetization. Daniel, do you want to elaborate more on '25?

A - Daniel Ek {BIO 16541022 <GO>}

Yeah, sure. I did touch on this in my opening remarks, but we're -- I'm coining this year the year of accelerated execution. And basically what that should mean for investors is we think we can pick up the pace dramatically when it comes to our product velocity. We're going to double down on music and we're going to be very disciplined while doing it. And because of all the advancements in AI, because of where our org is, we feel really good about being able to do this.

A - Bryan Goldberg {BIO 22029069 <GO>}

All right. Our next question is going to come from Eric Sheridan on capital allocation. Given the company's rising profit trajectory, can you discuss how management thinks about the potential and/or scope for capital returns to shareholders?

A - Christian Luiga

Thank you, Eric. As I -- as you're fully right, we are actually seeing an improved trajectory on the profit side, but also on the cash flow side, as I said in my remarks. We have also to remember that this is our first year of profitability and we do want to figure out how we actually invest and can invest in returning the potential through our business and we are prioritizing our business first and I think that's the key message. And as I said, if excess capacity rises, we will, of course, take shareholders into consideration.

A - Bryan Goldberg {BIO 22029069 <GO>}

All right. Our next question is going to come from Jessica Reif Ehrlich on label relations. Your recent deal with Universal Music Group was completed earlier than usual. Can you provide some of the flexibility or benefits that were not available prior to this from Spotify's perspective and how this may impact new services?

A - Daniel Ek {BIO 16541022 <GO>}

Yeah. I mean I sort of alluded to this a little bit in my opening remarks too. So we look at 2025 as the year where we'll double down on music and we're very excited about what will come. And many of these things I can't talk about just yet, so you'll have to wait and find out on the product side, but we're very excited about it. But maybe as a general up leveling to this, if you think about sort of the history of where we've been as a company, most of what we tried to do in the early days was really getting people from piracy into a legal music environment. And to do that, we needed a very, very simple proposition. And that simple proposition was our freemium model. You could start using Spotify for free, try it out and if you like the product and you were using it, we added a lot of benefits for you to become a paying premium subscriber. And a lot of our consumers ended up doing that.

Over time then, we added a few other modes for you to pay for Spotify, like the family plan, like duo, like student plans, just to name a few that's been driving growth. The next version of the music industry, I believe, is one where we're going to tailor experience of Spotify to all of these different subgroups. One of them we've been talking about, which is the super fans. So I'm personally super-excited about this one and this is a product I've been waiting on for quite some time as a super fan of music, and I'm playing around with it now and it's really exciting and I can't wait to show you guys that. But that's obviously one of those things that we are talking to the music industry about bringing to the table. But there's more to come when it comes to this sort of not one-size fits all future of music, which we're excited about.

A - Bryan Goldberg {BIO 22029069 <GO>}

All right, our next question is going to come from Rich Greenfield on advertising. Advertising growth remains disappointing, while you're embracing programmatic, there seems to be a disconnect given the size and engagement of your audience and your rather lackluster advertising revenues. Can you help us understand why brands are not dying to be on Spotify given the momentum?

A - Christian Luiga

Thank you, Richard. Yeah, I first start out to say, yeah, we moved from brand sales into performance sales. It is clearly something that we recognized last year, we were late on the ball. So that is nothing to be sort of hiding away from. But from that, we actually made a decision then to move into programmatic and that takes a little bit time, but we are on the ball now. We have done the technical build-out. It's largely completed and we also now then are getting to a unified supply on our server, opening up for more demand on the bidding. As you know, we have started out now at Trade Desk and we're going to look to add more partners onto our platform. And as I said last quarter, yes, this is a little bit late, but we have a stable transition and this year 2025 will be the year of building and 2026 when we think we're going to get scale. And I think we're delivering on time now when we know what to do and we have happy partners and we are happy.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Our next question is going to come from Justin Patterson on pricing. It seems like we're entering a price inflationary market with Amazon announcing price increases last week and labels wanting more frequent price increases. Given your breadth of content and feature leadership, how do you think about your adjusting price to value in an inflationary environment?

A - Alex Norstrom {BIO 19813860 <GO>}

Thanks for the question, Justin. This is Alex Norstrom here. The way we think about ARPU growth going forward is, that it's a function between really three things. It's price adjustments, future tiering and then also selling add-ons to our existing subscribers. And with respect to price increases, specifically, as Daniel has mentioned before, this is now a part of our toolbox. We take great care in the steps to balance the value-to-price ratio. Over time, this is something we've mentioned before as well. And when it comes to value, the way we do it is, we add value by way of features and content experiences.

And you can see us in the last year here adding AI, things like AI playlist, Jam and so on. And we've continuously just increased the size of the number of audiobooks we have. We have 350,000 audiobooks now in 10 markets. We have 67 million video podcasts. We pretty much have the world's entire catalog of music. And then as far as price goes, we adjust price where it makes sense. And then our subscribers reward us with more love, more engagement, and sticking around. And so really the key takeaway here is that we believe Spotify is one of, if not the most loved and highest-value in subscription entertainment.

A - Bryan Goldberg {BIO 22029069 <GO>}

All right. Another question from Rich Greenfield on video. Daniel, video is clearly important to you, but it's still a small fraction of time spent with Spotify today. Would you be able to quantify that amount of consumption? And do you have a long-term goal for mobile time spent with video versus audio only? And will the TV play a role in video's growth over time?

A - Gustav Soderstrom {BIO 20561192 <GO>}

Hey, Rich, this is Gustav. I'll take that question. So as you know, we had this event in LA in November that I mentioned, where we launched a new video offering. And as you know, I think podcasts are becoming video, this is very important to us. And so we saw this pretty early on and we pivoted our model to build both a better creator experience with the premium payouts, but also importantly a better consumer experience where premium users in these currently four markets receive an experience uninterrupted by ads.

And we launched this just recently, but we are very pleased with what we're seeing so far. So about 70% of the eligible creators for this offering have already opted in, which is above our expectations. We're very happy about that. And we already have more than 300,000 video podcasts and this is growing and we have about 6 million total podcasts. So we're very happy with the engagement we're seeing. It's very early, but we're very happy with it. And when it comes to engagement, obviously, we always want to maximize engagement across all platforms. As -- I think you know, we invest heavily in ubiquity and that includes TV. So we've been investing in the TV experience for several years and it is a very important part.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Next question from Benjamin Black on margins. Gross margins came in above expectations this quarter. Could you dig into the drivers of variability here? And also could you help us understand the trajectory of gross margins and operating margins for 2025?

A - Christian Luiga

Thank you, Ben. The gross margin for quarter four was -- I mean, we said the content cost favorability. And as you said, there was a one-timer on the impairment coming through. And I'm not going to go into more details on quarter four, but I just want to give you Ben, a little bit on the drivers going forward. We don't give a guidance for the full year, but we do try to make it as easy for you as possible. And that's why in the same time, as we said that we're going to plan to make targeted investments in our core offerings and we have done that before. We have done it in audiobooks and we're now doing the video and we're saying we're also going to invest in music this year, that will then come through the year.

But to give you some kind of -- something to hold on to, we also said that this will be more variable over the course of this year, but in the end of the year, it should be higher than we ended in 2024 for the full year. And the quarter four will also be higher than quarter one. And I think with that, you just -- you can imagine that there will be possibilities for distortion, but it was also that there is an investment that needs to come through this year to drive the growth we are looking for in the business. And finally, I just want to on that also mention that the seasonality will play in as well.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. All right. Our next question is going to come from Batya Levi on the Spotify partner program. How has the response been from the creators, your partner program? Can you quantify the impact you expect on margins in first quarter from the program and does it ramp from here? And what are some opportunities to monetize this investment in the future?

A - Daniel Ek {BIO 16541022 <GO>}

Yeah. I assume you mean the creators on the video side. And as Gustav already mentioned, we've seen tremendous results and a very big uptake on video podcasters coming to the platform overall and now more-and-more of them are obviously adopting our partner program as well. So we feel really good about it. And then as Christian mentioned in the last question, as it pertains to margins, I think his answer, I don't need to regurgitate it. I think it was a pretty solid one, which is, we feel really good about it on the year, but maybe some variability in the quarters.

A - Bryan Goldberg {BIO 22029069 <GO>}

All right. Our next question is going to come from Deepak Madavanan on user plans. Recently, some of us family plan users were prompted to enter our zip codes. Spotify family plans are somewhat widely shared by people outside of the household by many. Do you see opportunity for sharing crackdown in the family plan?

A - Alex Norstrom {BIO 19813860 <GO>}

Thanks, Deepak. Alex here. It is just wild to see how popular the family plan is. It's making up a big proportion of subscriber base. And we constantly make changes to make sure that users and subscribers use the family plan in the right way. And as we kind of go along, we see that there are positive results coming off of this and we're just going to continue to innovate and iterate on this.

A - Bryan Goldberg {BIO 22029069 <GO>}

We've got another question from Doug Anmuth on MAU, the funnel. Can you talk about the drivers of the record MAU net additions across marketing, promotions and other factors and how does this position Spotify for premium subscriber additions in 2025?

A - Alex Norstrom {BIO 19813860 <GO>}

I'll take this, Doug. It's Alex again. So if you take a step-back and really think about what we're doing here, it's -- we believe that music is the most beloved art form in and around the world. And if you add to that the video podcasts and then also our recent entering into the books market with audiobooks, we just see this enormous time ahead of us. So there's plenty of headroom for us to grow. The most important thing is that we are relentlessly focused on building this -- what we call the best and most valuable subscriptions offering for paying users around the world. And I'm really happy to report that our strategies are working. If you, for instance, take a look at the monthly time spent on Spotify, it's one of the highest compared to any of the top entertainment platforms out there. Our subs just love the wonderful combo of music, video podcast now and audiobooks.

And it's worth repeating that in Q4, we had 11 million net-adds, which was a record tied with Q4 in 2019 and the growth was really just broad-based across geo product with US and emerging markets leading the outperformance. We even saw some progress for the moment in a day that users use Spotify -- subscribers use Spotify. And one interesting stat is that we're now second only AM and FM radio in the US in cars. So the sub to MAU ratio is roughly 40% now and in more developed markets is 50% or even north of 50% and the bottom-line here is that the funnel is strong around the world.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Got another question from Michael Morris on competition. Can you expand on the shifts in competitive dynamics and select developing markets comment from your shareholder deck? And are these positive or negative shifts? Are they all from the same competitor? And how long do you expect the impact to continue?

A - Daniel Ek {BIO 16541022 <GO>}

Yeah. So again, there's always competitive dynamics. We're obviously operating in a highly competitive marketplace with lots of competitors. That's not news to us. That's something that's existed really from the beginning of the start of this company and keeps being the case. And we have everything from sort of global tech platforms as competitors to sometimes local regional ones. What tends to happen is that local regional ones tends to be quite -- when it's early stages of markets, they tend to be quite present. And then as the market matures, they tend to fall away.

And so what we were specifically referencing in this case was a net positive to Spotify, where one of our competitors fell away in the marketplace. But again, overall, lots of competitors exist in its marketplace. We're focused on driving the best product. The best product will have the most engagement. The most engagements will mean the highest lifetime value, which of course, is the driver of the business. So nothing really to see here except the sort of normal play.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Next question from Rich Greenfield on education. Can you explain how you're thinking about the education and courses product that initially launched in the UK? What have you learned to date? Is it a video-first product, the audio-video mix? Will there be ads in educational content?

A - Daniel Ek {BIO 16541022 <GO>}

Yeah. So it's really early days when it comes to our educational program, but it's a category that I'm personally quite passionate about. What I can say so far is that we're really pleased with the early developments. There's been millions of subscribers in the UK that have seen educational content. There's been a very strong demand in terms of people trialing out the educational part and even sampling it. So far, very positive early indications. But these are very, very early days. And if you know this company and known us for a while, this is quite oftentimes we do experiment quite a bit in different verticals.

Sometimes we pivot with these learnings, sometimes we double-down and scale. It's a space, however, that is quite exciting and maybe to put that in perspective for investors. So the global entertainment industry is probably somewhere between $2 trillion to $2.5 trillion case. If you look at the global educational marketplace, it's $6 trillion, $6.5 trillion in totality. But if you remove sort of basic education or elementary or K-9 or K-12 education, it's about $2 trillion to $2.5 trillion. So the space of knowledge versus entertainment is an interesting one.

And if you think about Spotify as a product, one of the most amazing things for us is we're not a pure-play entertainment platform. We are also a platform where people spend a lot of time educating themselves already with podcast, with audiobooks. So education is really a quite natural step and extension into that journey, but it's super early days and you should not be surprised if we keep on experimenting, improving, or pivoting the products that we're putting out in the marketplace.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Our next question is from Michael Morris on our premium business. Premium subscriber addition significantly exceeded your fourth quarter outlook at 11 million and were an acceleration compared to the fourth quarter of 2023. Why do you forecast the slowdown to 2 million net-adds in first quarter of '25 relative to the 3 million you added in the first quarter of '24?

A - Christian Luiga

Yeah, thank you. It is true. We did acceleration and very happy about quarter four. We said the Wrapped developing markets our competitors moving out was recent that we overperformed. And that usually brings a little bit of a hangover into the first quarter, and first quarter also from a seasonality point-of-view is usually weaker. Then, of course, as always, how we do our product marketing strategy for the year and over the year will also have an impact of how we see things. But we feel -- I think the most important message is that for the full year, we see a healthy growth still for the company.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Our next question is from Justin Patterson, also on the subscriber business. Given the progress in margins and retention, how are you thinking about reinvesting in marketing or adjusting pricing features in rest-of-world markets to drive the next wave of subscriber growth?

A - Daniel Ek {BIO 16541022 <GO>}

What I would say is, for sort of the near to mid-term, the profitability and growth of profitability for the company still will be very much our developed markets. But with that said, what I'm particularly pleased about in Q4 and maybe even the back half of the year is the development of the emerging markets. We saw it pretty clearly in MAU topline growth. And I think that's due to a lot of the tweaks that the teams have been doing that gets people in the funnel. We're trying to increase engagement. I feel really good about some of the music things we're planning across the year. That will drive even further engagement in those emerging markets. And when we have very strong engagement, it typically then always correlates with strong conversion to subscriber growth. And this has been the case from the early days of Latin America where people were questioning how big that market could be.

And I now think everyone realizes it's a very big market and can be a meaningful additive driver for both the revenue and profitability for both the company and the music industry holistically. And I certainly believe that will be the case for these emerging markets too. I also want to note that in Q4, we did see a positive trend on subscriber net additions from emerging markets too. So we are making progress on that front, but I think that there's just to set expectations, you should expect more of the profitability growth to come from developed markets rather than emerging markets. But over a long time, we feel very confident, places like India and others will be substantial businesses to Spotify that will deliver.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. We've got a question from Ben Swinburne on label relations. How does your new agreement with Universal Music Group impact your ability to continue to diversify your service beyond music, while at the same time drive improving margins? Should we expect any changes to how your music royalties are calculated over time as a result of this quote-unquote Streaming 2.0 agreement?

A - Daniel Ek {BIO 16541022 <GO>}

Well, I'll start and maybe Christian wants to add something. So first and foremost, I think you know, one of the most common misconception that I quite often hear from analysts is that they believe that there is a win-lose dynamic between us and the labels. Ever since starting this company 18 years ago, that's not how we've looked at this. We always look at this as a win-win dynamic. And if you want to simplify it to the very core, everything for Spotify is, if we get meaningful scale, our margins and our profits goes from there. So the first really, I would say, 16 years of the company, all we were focused on was driving meaningful scale. We did not worry about profitability. And so that's why you heard me say we have a great product, but not necessarily a great business.

Bloomberg

Through cost reductions, but then also through the year of monetization, I think we're now proving that we're a great business too. And much of that really comes from that added scale that we're now operating at. Like most platform businesses, more scale begets more profitability. So that's what I can say at the simplest term. As usual, we will not comment on any of the specifics with the deal negotiations other than to say that we believe this sets us up for very strong growth. And if we're growing very nicely, our label ecosystems and our partners will benefit from this too, and that's what we call the win-win.

A - Bryan Goldberg {BIO 22029069 <GO>}

We've got a question from Rich Greenfield for Christian. Having a few months under your belt now here at Spotify, what differentiates Spotify's culture? And have there been any meaningful changes you've made since starting either structurally or philosophically?

A - Christian Luiga

Thank you. That is, of course, an interesting question for me. I'll -- maybe I'll ask actually Daniel in the end to see if I've done some meaningful changes, but it's quite early days. I would say that coming into this company and thinking about what is it that makes it different and what is it that I feel that is strong culture in this company. I would say that there's a couple of things. One is that the focus on how to create value through the technology and platform is very strong in the company and you feel that when you get into the company. The other thing on focus is that it is a very focused company. So the company and my colleagues and myself, we are very focused on whatever we want to do, make sure we try to stay focused.

And I think that is in an easy way trying to explain how this company feels like. And it's also then -- which is maybe important also, it is important is that it's also fun to be here. When it comes to my own work and what I'm thinking about, I'm thinking about how I can then come in with my leadership and my experience and with the help of my colleagues here, how we can improve our scalability. That's where I try to put my focus and work on through the structure we have and the structure we can have, how do we get to those -- those proof points that actually make us make a difference when it comes to scalability over-time. That's where I'm trying to work right now. Anything to add, Daniel, on my...

A - Daniel Ek {BIO 16541022 <GO>}

I think the main thing people can see from Christian coming in is, he used to have a suit and tie on everyday and as evident from Spotify's culture, he's now sitting in T-shirts, so we're loving to see that difference in culture showing up.

A - Bryan Goldberg {BIO 22029069 <GO>}

We've got a question from Eric Sheridan on advertising. Can you discuss how to think about the building blocks for growth in the company's advertising business as we progress deeper into 2025? And how might video inventory around creator efforts accelerate the ads possibility?

A - Alex Norstrom {BIO 19813860 <GO>}

Great question, Eric. It's really a question of how supply meets demand. And if you think about the advertising market, it's just growing, growing. Some say that it will grow from $1 trillion to $2 trillion in the next decade. I don't know what the number is. It's just clear that it's growing. And on the supply side, if you look at Spotify, we have a pretty distinct and unique inventory of audio engagement, which is very high and so very sticky. And if you think about how we've treated our supply before on the free trails [ph], we've generally just used direct sales to meet this demand. And so the difference now from -- before is that we are going to implement automation and programmatic and the idea with that is simply to just be saying, hey, we're open for business now and we're going to have our supply meet the -- every increasing demand that's out there. And as far as video goes, it's a format that is obviously very potent and very attractive. And the more video inventory grows, the more supply we will have and the more demand we'll be able to meet?

A - Bryan Goldberg {BIO 22029069 <GO>}

All right. Our next question comes from Doug Brites [ph]on margins. What's driving the expected sequential decline in gross margins in the first quarter of 2025? And is your new deal with Universal a factor?

A - Christian Luiga

Well, I'm not going to go into details on the UMG part. But first of all, quarter one, I think the main driver in quarter one is seasonality. Ad sales is usually weaker and it is a weaker quarter. And therefore, the gross margin will be always a little bit lower in that quarter. But on top of that, we have made several investments in video and others and this, of course, will also impact margin, but without going into any details, that's what I'm going to say.

A - Bryan Goldberg {BIO 22029069 <GO>}

And we've got a sort of a related question from Mark Sketovich [ph] on margins. Now that podcast is breakeven on gross profit, how should we be thinking about podcast expense trajectory exiting 2024? And when can we expect accretion?

A - Christian Luiga

Well, as you say, we have then moved into an essentially a breakeven point on that perspective of profitability in podcast, but we also do the investments now going forward into video. So you should see it a little bit like with audiobooks. We targeted disciplined investments that will create future value for our customers and investment that we believe gives healthy returns over time, but also can have an impact on the margin as we take us there.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay. Our next question is from Maria Ripps. How is Spotify thinking about skippable versus non-skippable podcast ads for premium users, including the relative trade-offs between the user experience and the monetization potential? And technologically, how onerous would it be to implement non-skippable ads given most podcast ads are served in episode?

A - Gustav Soderstrom {BIO 20561192 <GO>}

Maria, this is Gustav here. I'll answer that. So this is what we announced at the LA event in November. And the way to think about it is that for videos, we are now offering precisely this. We are offering a podcast -- video podcast without dynamic ad interruptions. And as you say, what we had to solve there was the monetization. So we are instead paying out for these video podcasts to these creators, so that they are not making less money, if fact, they're making the same or more. So we're doing that for video podcast right now, we're not doing it for audio podcast yet. For technical reasons, they work differently, the ad stacks, there is something called dynamic ad insertion in podcast that doesn't really exist in video, et cetera. So we're doing this for video right now. No plans for audio at the moment.

A - Bryan Goldberg {BIO 22029069 <GO>}

Our next question is from Ben Swinburne. Can you share your perspective on artificial general intelligence and how it might benefit Spotify's business over the long term? Do you need to invest meaningfully to capture this opportunity or has DeepSeek shown the benefits can be accrued sooner and at lower cost?

A - Gustav Soderstrom {BIO 20561192 <GO>}

Hey, Ben, thanks for the question. I appreciate that. This is Gustav. So quickly how to think about AGI or ASI artificial superintelligence, and Spotify is that AI really drives three areas for us. One is, as for any other tech company, just productivity, both in -- when it comes to writing code, but also in general. And as everyone else, we're very aggressively adopting coding assistance, et cetera, and seeing great productivity increases. So that's one benefit of AI.

The other one that maybe we haven't talked much about is actually moderation costs. So you've seen Spotify launch comments, for example, on podcast that are very successful for us. We get a lot of people commenting. This is something that we can only do because of AI. Previously, the cost of moderation were just prohibitive for a company like us. So that's been a great boon for us.

And then the third area is obviously the user experience. Maybe the most obvious thing in the user experience is actually the recommendations, which is one of the biggest impacts. And it's important to know that even though we've been doing recommendations for a long time, they actually benefit even more from this new generation of AI. But there are also new experiences like the AI DJ, AI playlist, et cetera. And we think that we are investing at a prudent level in AI today.

And when it comes to DeepSeek, we see this as sort of further evidence that these large AI models and intelligence in general is getting commoditized in open source pretty fast, meaning that the dollar cost of unit per intelligence, if you want to think about it like that, it keeps dropping rapidly and the industry forecasted to drop even more. So we feel we're investing at a prudent level and we'll continue to do that. I look very good at our position right now and our level of spend.

A - Bryan Goldberg {BIO 22029069 <GO>}

All right. We've got a question now from Richard Kramer on the premium business. What sort of price elasticity do you expect when you consider further price hikes? Do you have any sense of the portion of your base, which might pay a premium or a super fans or HiFi tier if you finally launch one?

A - Alex Norstrom {BIO 19813860 <GO>}

Hey, Rich, Alex here, it's good to hear from you. As discussed before, price adjustments is now part of our toolkit and so we do it continuously and in markets where we raised prices in this previous quarter in Q4. Our churn was low and really in line with what we've seen with other increases from before. And as far as the super fans and HiFi tier goes, obviously, we do research and primarily we talk to our own users to ask them who is interested in what products and what additions and so on. And I can tell you that as we scale and now we've scaled to 263 million subscribers, there is more and more people that are interested in something like a super premium tier. And as Daniel told you, I'm also super-excited about this product that we're working on, but have nothing more to share from that currently.

A - Bryan Goldberg {BIO 22029069 <GO>}

Okay, we've got a question from Kannan Venkateshwar on -- also on premium. Could you talk about the potential for tiering pricing by content instead of degree of access like family, duo, et cetera? And is there flexibility under your agreements with content providers for say a podcast tier?

A - Daniel Ek {BIO 16541022 <GO>}

Well, I mean some of this Alex already touched upon that we're sort of moving from this one size fits all to this much more sort of specialized tier as the base of consumers are growing into the hundreds of millions. And so I think that while I can't answer the specifics, what I would say in general is you should expect there to be many more versions of Spotify in the future that will adapt to all the various sub-segments of this now 263 million base -- strong consumer base. And so, yeah, we're very excited about sort of entering into that new era of a more tailored Spotify for your needs.

A - Bryan Goldberg {BIO 22029069 <GO>}

Right. We've got time for a couple more questions. Looks like the next one is from Mark Mahaney on Marketplace. Can you provide any update on two-sided marketplace as growth remained consistent?

A - Daniel Ek {BIO 16541022 <GO>}

Thank you. Yeah, our marketplace initiative contributed to another year of strong performance. The full year 2024 was growing roughly similar to 2023. And I think the important thing is we see the adoption of the product across all customer types and that is very good and the inventory expansion from our MAU and the higher engagements is also visible. And we do expect then that the healthy double-digit growth to continue -- it will continue into (technical difficulty).

A - Bryan Goldberg {BIO 22029069 <GO>}

We've got a question -- another question from Richard Kramer on the product side. What did you learn from using the Google NotebookLM for Wrapped? What was the customer reaction? And how might you amend this in 2025? And then finally, with R&D expenses down approximately EUR200 million in 2024, is there more efficiency to be realized in 2025?

A - Gustav Soderstrom {BIO 20561192 <GO>}

Yeah. Thanks, Richard. Gustav here. So if we start with the Google NotebookLM and Wrapped, yes, we did build a very unique and first-of-its-kind experience. It's actually sort of the first-ever podcast about you, where we took data by users and built a deeply personalized story about your year and this was deeply appreciated by users. So we learned two things. We learned that our users love personalized storytelling. We kind of knew that through Wrapped already. This was just taking it one-step further and leveling up.

And why are we doing this? Well, we think that AI presents a great opportunity for products. It's very important for us to always be at the very cutting edge of this. People talk of sort of a product overhang that there's also capability, but no one is building the products yet. We want to be the company that builds those products. We want to be the company that's the best in the world at building AI-based products. This is why you see us innovating and trying these things before others. And we learned a lot about how to do this at scale. Obviously, doing this for one user is one thing for hundreds of millions on a single day, it's a very different challenge.

We already had a very good relationship with Google because we're hosted on GCP, but we leverage that to do something that even they haven't done at this scale before. We learned a lot about what users like we learned a lot about how you build these experience in a scalable, but still safe way, which is always tricky when you're doing it at scale. So this is something that you will see us do more off in the future in terms of deeply personalized AI products. It was a great learning experience. We had a lot of fun.

A - Daniel Ek {BIO 16541022 <GO>}

I'd maybe add, it took us what was it three months we did it from start to finish?

A - Gustav Soderstrom {BIO 20561192 <GO>}

It was less than that actually.

A - Daniel Ek {BIO 16541022 <GO>}

Okay.

A - Gustav Soderstrom {BIO 20561192 <GO>}

I think we came up with it about six to eight weeks before we launched.

A - Daniel Ek {BIO 16541022 <GO>}

Yeah. So okay, well, pretty fast, which I think gives us also a lot of confidence that we can speed things up in 2025 as well, which is why we set the target we did for accelerated execution for the year.

A - Bryan Goldberg {BIO 22029069 <GO>}

Great. And our last question today is going to come from Justin Patterson on a related topic on product innovation. Gustav, it seems like your team is innovating on product faster than ever since the 2023 reorganization. As you look to 2025, how are you thinking about the pace of feature launches and evolving the product from here?

A - Gustav Soderstrom {BIO 20561192 <GO>}

Thanks, Justin. Appreciate that vote of confidence. We are thinking about it this way. So as Daniel mentioned, we are speeding up and we intend to speed up even more. The last two years, Alex and I have been running the company in a fairly unique way, which is very synchronized. We actually don't have our own direct reporting teams. We have a single team together that is called the eTeam [ph], which really represents the people who run Spotify. It's about 15 people. And what we do is we work in increments of six months. Senior people in the company pitch their ideas for the company, something called Bets.

Alex and I then prioritize these into something called the Bets Board. It's a stack-ranked list of what Alex and I want the company to achieve within the next six months. And then we send this list out to the company and the company commits to this. They spend about one to two weeks committing to this, coming back seeing what they can do. And then we're heads-down working for six months on this plan. This has proven to be very efficient for us. It means that everyone in the company has the same view of what it is we want to do. People don't fight over priorities because they're so clear. And this is one of the reasons why we're speeding up and we think we have more to gain there.

A - Bryan Goldberg {BIO 22029069 <GO>}

Great. Well, that concludes our Q&A session for today. I'd like to turn the call back over to Daniel for some closing remarks.

A - Daniel Ek {BIO 16541022 <GO>}

All right. Well, I'm very, very excited about 2025. And I think you guys and hopefully you feel it too after this Q&A session too, but we feel really good about where we are both as a product and as a business. And we will continue to place bets that will drive long-term impact, increasing our speed while maintaining the levels of efficiency we achieved last year. And I think it's really this combination that will enable us to build the best and most valuable user experience, grow sustainably and deliver creativity to the world. So thanks again for joining everyone.

A - Bryan Goldberg {BIO 22029069 <GO>}

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

Operator

This concludes Spotify's Fourth Quarter 2024 Earnings Call and Webcast. Thank you for your participation. You may now disconnect.