Spotify Technology S.A.

Spotify Technology S.A. - Q2 2023 Earnings Call

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Event Participants

Executives 3

Bryan Goldberg, Daniel Ek, Paul Vogel

Operator Operator

Good morning. My name is Julianne, and I will be your conference operator today. At this time, I would like to welcome everyone to Spotify's Q2 2023 Earnings Call and Webcast. [Operator Instructions] I would now like to turn the call over to Bryan Goldberg, Head of Investor Relations. Thank you.

You may begin your conference.

Bryan Goldberg Executive

Thank you, 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. [Operator Instructions] 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'm going to turn the call over to Daniel.

Daniel Ek Executive

All right. Hey, everyone, and thank you all for joining us. I hope you all had a chance to review our shareholder deck. And as you can see, it was a very strong quarter. We beat our own expectations again across both MAU and subs.

And in addition, it's really gratifying to see the outperformance in growth that continues to come from markets all over the world. So let me share some more context on the growth this quarter before we go into what it ultimately means for the business. So this quarter netted the highest MAU growth in Spotify's history. And 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. And 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 is a really powerful funnel where the more our users discover and engage the more they're willing to pay for an enhanced experience. And with 6 quarters of MAU outperformance, we are capitalizing on this momentum and is proving to have a meaningful effect, helping us achieve 10 million net new subscribers this quarter, 3 million more than we originally anticipated. So now let's talk about revenue growth. There are 3 ways for us to drive revenue growth.

We can grow our users, we can create new business with new revenue streams, and we can increase 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. And to that end, as most of you are now aware, Yesterday, we announced broad price increases across more than 50 markets, including most of Europe and North America. And we've carefully waited this decision, but we 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've conducted over 50 price increases already.

And this experience, coupled with our strong offering, put Spotify in an excellent position to make this move. And while this won't impact revenue per user much up until the end of Q3, we expect it to have a meaningful impact on Q4 and beyond. And 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. And this gives me a lot of confidence. So looking back at Spotify, the lesson we have learned is the daily progress even if faint is more important than the occasional clash of brilliance we've had. Therefore, I believe that the speed of iteration is perhaps the ultimate leading indicator of our long-term success. And with that, I'll turn it over to Paul for more detail behind the numbers, and then Bryan will open it up for our Q&A.

Paul Vogel Executive

Great. 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% year-on-year to EUR 3.2 billion during the quarter. Our FX-neutral growth was 14% and accelerated versus 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 rationalize 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 EUR 135 million of net charges in the quarter with EUR 44 million flowing through gross margin and EUR 91 million flowing through our operating expense. About EUR 25 million of these charges were cash related.

With that context, adjusted gross margin, which excludes these charges, was 25.5% and in line with expectations. As a reminder, we guided gross margin excluding potential onetime charges. Adjusted operating loss of EUR 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 EUR 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're also forecasting EUR 3.3 billion in total revenue a gross margin of 26% and an operating loss of approximately EUR 45 million. First, looking at user and subscriber growth. We've 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 upfront 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 the same point last year, roughly 30% better.

And turning to revenue, we are forecasting a 600 basis point 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 will be closer to EUR 3.5 billion, reflecting our expectations for accelerating currency-neutral growth to 16% year-on-year versus the 14% growth that 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 increases will have a small impact on Q3 revenue given building 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 margins through the balance of 2023 as well as improvements in our operating loss. And with that, I'll turn it back to Bryan for Q&A.

Bryan Goldberg Executive

All right. Thanks, Paul. [Operator Instructions] And our first question today is going to come from Justin Patterson on efficiency. Daniel and Paul efficiency has been a major theme for you in 2023. As you look at actions taken this year and consider your long-term margin targets.

Where do you see opportunities to be more efficient while still ensuring you have the right level of investment to support revenue growth?

Daniel Ek Executive

Yes. I'll start, and maybe Paul can chime in. So I think, again, if you go back to some of the remarks I had at the beginning of the year, really 2 things. One, the most notable thing is that the hurdle for any new investment that we're going to make is going to be significantly higher going forward. And in particular, I think you should view our investments in our own OpEx as a great indicator of that.

And then the second part, I talked about this in the beginning of the year too, which is we probably got a little bit ahead of ourselves in that investment. And so we've rightsized our staff related to that. So I feel good -- much better about the overall OpEx and where we are. So I think going forward, you should just assume that the numbers on a percentage of revenue should come down because we're going to not increase our OpEx to the same extent that we have had in past years.

And maybe just the final bit here is we invested on the backdrop of all the amazing leading indicators we saw. And I do want to remind all of U.S. investors as well, the phenomenal now 6 quarters of outperformance on MAU growth that is now translating really nicely into subscriber growth as well. So I feel really good about those investments. But we obviously probably got ahead of ourselves a little bit on that, and now we're going to stay steady on the investments we've already made because we're seeing great results from them.

I don't know if you want to add something, Paul?

Paul Vogel Executive

Yes. I'll just add a few things. One, I mean, if you look at some of the changes we made both this quarter and the beginning of the year, Q2 was the last quarter where we had headcount higher year-over-year. We expect our head count year-over-year to actually be down in Q3. We'll see where that goes moving forward.

But as Daniel said, we're continuing to become more efficient. We're continuing to find ways to innovate and launch new products and experiment at the current level. So we feel really good about where we are. So you will see some of that efficiency have even more of an impact in the back half of the year with respect to the OpEx.

Bryan Goldberg Executive

All right. Our next question is going to come from Justin Patterson again. This one on AI. Daniel, we've started to see AI extend beyond discovery into areas like the AI DJ what additional opportunities do you see for AI across the product portfolio? How should we think about AI potentially influencing podcast or even audio book growth over time?

Daniel Ek Executive

Yes. I think we're in the early innings of even seeing all what's potential. And I assume with the question that you're talking more about Generative AI [indiscernible]. But for the purposes of this, I think there's almost 3 major applications. We still think there's enormous benefits of just core machine learning or AI improvements.

in discovery. So that's going to be massive. And you can see some of those improvements already paying off very nicely and higher engagement and higher retention, which then lowers churn. This is a trend that's been going on now for many years. So I still think that there's quite a lot that we can do there that will improve engagement and retention over time.

And then the second bucket, of course, comes into Generative AI, and AI DJ is a phenomenal product. It's probably one of my personal favorites over the last few years that we have developed, and we've seen really strong consumer interactions with that. And that just talks about the ability for us to contextualize and personalize all the amazing content that we already have. on the Spotify platform. So I think you're going to see a lot more of that where we can contextualize and personalize content across the entire platform to make it more accessible.

So an easy way to think about it as an investor is, if you think about podcasting today, it's really high-quality content, but it requires quite a lot for you to get into new podcasting. So one very easy thing we can do with these new AI developments is, of course, summarize what these podcasts are about. And by doing so, you can imagine it becoming a lot more easier to merchandise new podcast for consumers, which drives in term higher engagement and more growth for creators, which is a really positive thing. And then lastly, I would say just making the company overall more efficient. And I think this is probably the part that most people are investing in, in the broader ecosystem, but not enough credit yet of understanding among investors is happening.

But I significantly believe that we can become a lot more efficient as a company by leveraging AI. So a great example of that would be if you think about advertisers today, the cost of generating new advertisements on Spotify is quite a big thing, especially on audio ads. By using Generative AI and our tools here, I think you're going to be able to see that we can significantly reduce the cost that it takes for advertisers to develop new ad formats. And that obviously means that you as an advertiser instead of having one ad, you can imagine having thousands and tested across the Spotify networks. Things that you could easily do today using text, but you haven't been able to do over video or in audio.

So there's going to be a lot of those opportunities where we're going to be not just on the consumer side, but really across the entire company become a lot more efficient, which will drive more value for all stakeholders, consumers, creators and Spotify itself.

Bryan Goldberg Executive

Okay. Our next question is going to come from Matthew Thornton on price increases. What does third quarter revenue guidance assume in terms of timing and subscriber guidance assume in terms of churn and gross intake? And do you think a structure is in place with the content owners to now incentivize regular or recurring price increases?

Paul Vogel Executive

I'll take the first part of that and maybe I'll let Daniel take the second part of that. So the guidance assumes on price increases, the way I think about it is this way. We announced a price increase yesterday. Most people have a notice period. And then price increase won't -- it won't take effect until the next billing cycle.

So for most subscribers, they won't see a price increase until September, which is why I said they will have a minimal impact on Q3 because most of that price increase won't happen until the last month and probably somewhere in the middle of the last month of the quarter. You will see the full benefit of the price increase in Q4. So you'll see a bigger acceleration in ARPU and revenue growth in Q4 than you will see in Q3. In terms of churn and gross intake, it's not something we comment on. I will go back to my comments I made in my prepared remarks, which were definitely -- there's some conservatism baked into the Q3 numbers.

If you go back and look historically, and we've said this publicly many times. In the past, when we've raised prices, we've seen very positive results. We've seen minimal impact on gross intake. We've seen minimal impact on churn or variations in churn from trend. And so there's no reason to expect that wouldn't be the case.

This is obviously a much larger and more broad-based change than we've made in the past. So there's definitely some conservatism baked into kind of how Q3 rolls out. And then maybe, Daniel, I'll turn it over to you for the second half of that question.

Daniel Ek Executive

Yes. So I think the second half was around the structure that allows regular and recurring price increases. And I commented on that already. I think, again, we have in the past done over 50 already, so I don't want to overstate this price increases. But obviously, this is the biggest one we've done to date.

And I think I addressed it in my opening remarks, but I believe you should all look at it as a tool in our toolbox, but the overall goal is per market basis grow our revenue, and we're trying to grow at that 20% as we've outlined already in our targets. And so there's 3 ways to do that.

One is obviously to grow the number of consumers. That's our preferred way of doing that and keep the value to price super high because that creates optionality. But when user growth slows down, take Sweden as a great example, where we're already at a massive part of the population there, then price increases becomes an even more important tool in the toolbox. And then thirdly, of course, we have grown revenues through our new verticals or new products, which is also another tool we have in the toolbox, but of course, more longer term. So yes, I think you should assume that this is a tool we now have in the toolbox.

Bryan Goldberg Executive

Okay. We've got another question from Matthew Thornton on the ad market. Can you talk about the performance and linearity of the ad market through second quarter and into third quarter? And can you provide any updates on SPAN?

Paul Vogel Executive

Yes. So the quarter on the outside was pretty solid relative to expectations. We did see some improvement throughout the quarter. So definitely the back half of the quarter was better than the first half, although not that out of line with our expectations. We expect advertising to be even better in 3Q, which is baked into our guidance.

So on an FX-neutral basis, a better quarter from a growth perspective in Q3 than we saw in Q2. And then progress at SPAN. SPAN was a big driver of the outperformance. It definitely helped podcast ad revenue. Podcast ad revenue got better throughout the quarter as well in terms of growth rate.

So SPAN was a big contributor there.

Bryan Goldberg Executive

All right. Our next question is going to come from Michael Morris. In the past, you've referenced seeking a win-win scenario with labels prior to raising consumer pricing. Can you share detail about the when you achieved in conjunction with yesterday's announced increase? Will you pay royalties on the incremental revenue at the same rate as your current agreements?

Daniel Ek Executive

Yes. I'm not going to dive into specifics about anything in our agreements as per usual. But I will say that we are, of course, very pleased with where we are with our partners, and we feel really good about the situation. And that I believe -- again, I think I mentioned this in the past, but I feel like quite often this is being put in a situation where this is kind of a win-lose relationship between our partners and us. That is not how we see it.

We very much see it as, again, not a serious sam game, but a growing pie, and the goal is for both parties to be win-win. And I feel like we're at a situation where we are at a win-win with all of our rights partners. And I feel really good about the growth of Spotify, but also the growth of the overall music economy. And that's really the kind of main focus for us at Spotify is we're really trying to create a win-win, and I feel like that's the part that's often missing. But we're really pleased with where we are, both with this price increase and our overall position with our partners.

Bryan Goldberg Executive

All right. Our next question is going to come from Mario Lu on ARPU. ARPU declined 3% year-on-year, excluding currency in the quarter. Can you help break down the contribution from product and market mix and whether the price increases announced last week, we'll be able to offset these 2 negative impacts by Q4?

Paul Vogel Executive

Yes. Thanks, Mario. So the -- the biggest impact on the quarter was the product mix. That was the majority of the impact of the 3% decline FX neutral on ARPU. Looking out, the price increase will moderately help in Q3.

We're looking for FX-neutral ARPU kind of flat to down 1% in Q3, and then we should expect a meaningful improvement in FX-neutral ARPU in Q4 as we had the full benefit of the price increase in the Q4. So minus 3 this quarter, call it 0 to minus 1 in Q3 and then nicely positive. We don't obviously guide the Q4 at this point, but nicely positive in Q4 of this year.

Bryan Goldberg Executive

Great. Next question from Rich Greenfield. TikTok recently reached a new supposedly groundbreaking deal with the labels. How should we think about what this means for competition with Spotify?

Daniel Ek Executive

Well, again, competition is nothing new. It's something that we've been dealing with since the start of the company, and we have had many formidable competitors. And obviously, TikTok is one. All of that said, I think the results this quarter kind of speaks for themselves with the outperformance in users and outperformance in subs. I feel really, really good about the investments we've been doing over the past few years in improving our competitive position and improving the consumer value that we're having to our consumers.

And yes, I mean, again, competition isn't anything new. It is expected, especially in such a large category that so many consumers care about like music. So yes, really nothing to add more than that.

Bryan Goldberg Executive

All right. Our next question is going to come from Mario Lu on podcast economics. The second quarter podcast gross margin improvement. Can you give us a rough ballpark of where we are right now versus a time line of breakeven within the next year?

Paul Vogel Executive

Yes. We continue to see improvements -- the rate of improvement on the gross margin on the podcasting side. I would say that relative to all the expectations we gave at the Investor Day, we're right on track. We expect to hit all the targets we laid out for podcast and podcast breakeven and improvement in margins. And at a higher level, I think we feel really good about all the targets we laid out at the Investor Day.

Bryan Goldberg Executive

All right. And then we've got another question from Rich Greenfield. Everyone was expecting you to raise the base single user price, which has never gone up, but you also pushed through a $1 increase on the family plan in April of 2021. How do you think about your family plan pricing power versus the base tier?

Daniel Ek Executive

Yes. I mean, again, it's phenomenal value really for consumers, both the standard tier, but obviously, the family pricing as well. So we feel it's a great offering. And as we said before, we've been in the past waiting and kind of reviewing and building up more value. And that's really how you should think about it.

We are trying to build more value towards our consumers. That's where we start. And then when we feel like that gap, the value to price ratio is getting out of whack, you should now assume that we have a new tool in our toolbox, which is we have the ability to raise prices. And we feel good about doing that. And the family plan, of course, is an even better value proposition relative to the standard plan.

So that's another tier that we have the opportunity to raise prices on.

Bryan Goldberg Executive

Okay. We've got a question from Matt Thornton on streaming economics. Do you think the music streaming market will get to a structure where higher value is ascribed to premium music streams versus perhaps other content that may be perceived as less premium?

Daniel Ek Executive

I think what you're discussing is probably a variance around artist-centric rather than the sort of difference between ad-supported and premium parts. And obviously, this is kind of a big contention. How do we make the economic model fair for as many participants on the platform? And we're always making tweaks to that model. We're always reviewing how we can make the model more fair, and we're in constant dialogue with our partners around how we can do that.

I think the expectation from an investor point of view is -- however, is that it doesn't actually meaningfully impact Spotify's economics one way or the other. This is more around how we divide the pie from the rights holders and to what artists or what groups of artists we should do it. But most studies we've done in this is that even if you change it on a user-centric or an artist-centric approach. It seldom leads to these gigantic differences that most people perceive it to do. So again, we're in constant discussion with our partners, and we're always sharing data about what we see and they are sharing data back, of course.

But we're always open to hear how we can make the system more fair to more artists.

Bryan Goldberg Executive

All right. Next question from Maria Ripps. Could you comment on the June Bloomberg report that indicated you are planning on launching a HiFi tier later this year? What are your expectations for engagement and plan switching across different pricing tiers if and when you release this offering?

Daniel Ek Executive

Yes. We don't really have any announcements to make on this call around any new sort of features or things. We tend to do that directly towards consumers when we have them. What I will say, of course, is that HiFi remains something that we think has value, but it's something that has value to probably a more efficient autos in the streaming market and we're interested in, obviously, how we can use that as one tool to, in the future, increase our value even further. But we don't have anything to announce at this point.

Bryan Goldberg Executive

All right. Next question from Matt Thornton on the user interface. What impacts have you seen engagement, retention, conversion or anything else from the new user interface and how far along are we in the rollout of that new UI?

Daniel Ek Executive

Yes. So again, the user interface for those that may not be aware that I believe Matt is referencing is the one we announced at Stream On. And as we outlined back then, it was the single largest shift that we've ever made to the user experience, both on a look and feel, but more importantly, on the back end because we had to re-architect all the signals that are machine learning systems we're using as well. And what we're seeing is pretty good results. We have made lots and lots of tweaks based on user feedback, which is normal.

And we are making those tweaks. We're also making lots of tweaks on our recommendation based on this new signal.

So I feel really good about where we are, but it's an entirely new system. So we're being very, very careful about how we're rolling it out. And you should expect most of it to be rolled out over the remainder of this year with this new UI. But we feel good about it. And you should expect long term that engagement will increase.

And of course, if engagement increases that tends to lead to better retention, which in turn tends to lead to better conversion over time as well.

Bryan Goldberg Executive

Okay. We've got a question from Maria Ripps on podcasting. Last quarter, you talked about canceling or not renewing underperforming podcast content. Could you provide some further detail regarding how your original content strategy is evolving under more streamlined operations? And are there any audience demographics or genre types that you're more focused on now?

Daniel Ek Executive

Yes. I think, Maria, you're rightly pointing it out. I think the biggest shift in our strategy is really around the more streamlined operations and that we're being more careful about now that we have a lot more data around doubling down and renewing the things that did work and stop doing the things that didn't work. And I think that's the primary consideration that we're going through. And then in terms of any new genres or demographics, I think the most interesting thing from my vantage point is how the number of podcasters is growing.

So you're seeing more and more new podcasters come in and do that. And unlike before where perhaps we saw people in the very early innings that were native to podcasting and didn't do any other form of media, then when we kind of made the announcement, we brought new talent to the platform. Now we're seeing a lot of Internet native creators who are creating new podcasts for it. And I think our video podcasting is a great example of that, where we're seeing podcasters now realizing that they have on video feed on Instagram and YouTube and all these other platforms and now uploading more long-term content on Spotify with great success. So we are very much tailoring on the content type to these new creators broadening the base of podcasters feel really good about that.

And then on the consumer side, that tend to lead to much younger consumers getting in and starting to realize that podcasting is not just something for older consumers, but it's something that has a lot of appeal. It could be funny. It could be not just fact.

But you're seeing Call Her Daddy, a great example of younger women taking up to podcasting and loving the format. And we're seeing, obviously, something like Call Her Daddy also then cost reference when Alex Cooper brings musical artists onto the show, you're seeing great results in music streams as well. So nice sort of a brand Halo that then chimes onto the music side as well. So that's the expectations. We're going for more creators, which probably will lead to more younger consumers all around the world as well.

And more importantly, of course, the big shift being that it has to be efficient.

Bryan Goldberg Executive

All right. Next question from Doug Anmuth on sales and marketing. Do you expect sales and marketing to decelerate or decline year-on-year in the back half of 2023, given the heavy spending from 2022? And how does that influence your MAU and premium subscriber outlook?

Paul Vogel Executive

Yes. I mean, as you point out, Doug, it definitely accelerated in the back half of last year. So when you kind of think about it on a year-to-year perspective that the comps are what they are. So that's kind of number one. Number 2 is the last couple of quarters, we have underspent in marketing and still delivered exceptional user growth and subscriber growth.

And what we've seen is after a period of time where our LTV-to-CAC, which has always been pretty strong, kind of dipped a little bit, it's back and rising again and rising nicely. So we've seen a really significant improvement in LTV-to-CAC. We've seen an improvement LTV on a LTV to cost per gross add perspective. So we're seeing that officially come into play. So marketing is always going to be a part of how we grow.

It's not really a big factor in kind of the guidance we've given on users and subs in terms of any change to marketing plan or year-over-year changes at all. So I think we feel really good about the efficiencies we've got. And I think we feel really good about actually, the marketing spend we made that's now carrying forward, right? You go into new markets when you launch new markets and sometimes there's that awareness factor. And then once you get sort of that, for lack of a better word, flywheel to take hold, it really starts to have a take on a life of its own in terms of growth, and we started to see that in many of our markets.

Bryan Goldberg Executive

Okay. Another one from Doug Anmuth, this one on podcast content deals. As some meaningful podcast content potentially comes up for renewal, later this year and through 2024, how is your positioning discipline and thought process different from where you were when you were building out podcast a few years ago?

Daniel Ek Executive

Yes. I mean, the most notable one, I would say, not only are we in a different climate, of course, that's the obvious one, and that's something I've been addressing before. But I think also to set expectations where we were 4 years ago, we had very little data to back up our decisions on. So the most important thing is to contextualize it for investors. We were in a position where we thought podcast overall was undermonetized and underutilized by consumers and that we had a real chance of breaking into the marketplace.

But we were kind of nowhere when we enter the field. And today, we're #1 in most markets around the world. It is proving to be a growing media category, and we feel really good about it. So I think overall, it was the right bet to make and has played off really nicely, and I feel really good about all the impact it's having on our engagement and retention and lower churn.

So I feel really, really good about that part. Now that said, now we also have a lot more data. We have a lot more data across the millions of podcasts we already have about what that does to new user acquisition, to retention, to conversion, to subscribers, et cetera. And not surprisingly, what we're finding is that some of these shows work really well with our audience. Some of them don't work well.

Some of them work well, but during a different cost structure as we probably overpaid relative to what we should have done. And so we're coming at this with the process of rightsizing some deals, doubling down on some of the things that worked really nicely and then stepping out of some deals and relationships that hasn't worked out. But I think this is very normal given that we kind of went in, in order to get to really win the space and to gather as much data as we could in a short period of time. And so the data we have now is very rich and allows us to make much better decisions than we obviously could 4 years ago.

Bryan Goldberg Executive

All right. We've got a question from Richard Kramer relating to gross margin. What led to the favorability of other cost of revenues in the quarter? And how might that develop given the introduction of more video on the platform?

Paul Vogel Executive

Yes. So there's really 2 things on that. One is sort of our streaming delivery and compute cost and the other was on customer service, streaming delivery being the bigger one. I think a lot of that is honestly the maturation of the business and our ability to really think through and forecast some of the compute cost and streaming delivery costs for us, and so we've gotten better at it. And that has really helped us.

Last year -- if you remember, last year, after a period of time where they were going down, we saw a couple of quarters where they rose, we're now back in a position where as a percentage of revenue, they're declining again. We do feel like we have a better handle as a business on sort of forecasting and managing those costs going forward.

There can always be variations. There always might be some fluctuations. And with respect to video, if it would become a big enough portion that's something we'd have to manage through as well. But again, we have the models now to properly forecast it. So we feel like we're in a pretty good place with kind of maintain the levels we're at on some of those other costs of revenue lines.

Bryan Goldberg Executive

Okay. Another one from Doug about pricing power. How do you think about pricing power over the long term and Spotify's ability to innovate on product to continuously make it more valuable to users?

Daniel Ek Executive

Yes, Doug. The way we think about it is, we're constantly thinking about how we can increase the value that we give our consumers on the platform, no matter if they're on their ad-supported tier or our paid subscription tier. And really kind of increasing that sort of value to price ratio that we have. So I think so long as we're able to bring more value to our consumers, then we should have the ability to raise pricing over time as well to sort of narrow that gap. But we're always going to be focused on over-delivering on value towards our consumers on this platform.

And then when you think about the innovation, I feel really good about that. As I mentioned in my opening remarks, despite the efficiencies that we've now made across the business, we are at an all-time high on the number of experiments that we're doing and improvements. I mean just in the last quarter, as you could see in our shareholder deck, we've introduced an entirely new redesign of our desktop clients. Last quarter, we did one on the mobile client. We have updated Tesla this quarter.

We've updated many of our partner experiences. We've introduced AI DJ to a wide number of consumers and the list goes on and on and on of all of these improvements. And again, podcasting is still growing very nicely, still relatively early. Audio books is even more nascent in this business. And I believe long term, going to be very, very big for Spotify, similarly to how investors may not have necessarily understood podcasting early on.

I think audio books will be the next one where we will look back in a few years and say, wow, that became quite meaningful quite fast for Spotify. So I feel really good about us being able to add lots of value to consumers over time. And if we're doing that, I believe that we have the ability to then raise prices to keep the value to price ratio at an appropriate level.

Bryan Goldberg Executive

Okay. Our next question is going to come from Zach Morrissey on advertising. Music ad revenues decelerated to mid-single digits in terms of year-on-year growth in the second quarter. How did this perform relative to your expectations? And can you discuss the trends you saw through the quarter and into July?

Paul Vogel Executive

Yes. So at a very high level, revenue was right in line with our expectations. We're obviously dealing with some heavier currency than we expected. But if you look at both the advertising side and the premium side, we are almost spot on, on both of those with respect to our own internal forecast. So revenue was right in line with expectations.

We don't really guide to music or podcasting and advertising specifically. But I would say music was pretty much in line. The podcast was in line to slightly better. And so we saw good trends in advertising overall. So I would say again, to recap revenue right in line, not much of a difference either on the ad side or premium side with our expectations.

Bryan Goldberg Executive

All right. We've got a question from Mike Morris. What are the factors driving third quarter premium subscriber growth, the outlook that is below the prior year's level of net adds? Are there promotions or other activities that are driving increased quarterly variability? And how much is the announced price increase expected to impact net adds?

Paul Vogel Executive

Yes. So I'd probably take a step back first and just look at sort of subscriber growth in general. We outperformed in Q1 of this year. We outperformed in Q2 of this year. If you look at subscriber growth over the last 12 months, we've added over 30 million net subscribers, which is sort of a phenomenal and accelerating trajectory over any 12-month period of time.

So subscriber growth has been really, really strong. Obviously, user growth has been even better. I think we've added something like 118 million users over the last 12 months as well. So both of them have really been strong. And when you look at over a 9-month period, incorporating our guidance, we expect net additions in the first 9 months of this year to be up 30% relative to the net additions we had in the first 9 months of last year.

So that's just sort of the level set. And with respect to the absolute guide in Q3, well, one, we did significantly outperform in Q2. So there's always a question of how much, if any, we pull forward from Q3 into Q2, given it was our strongest Q2 ever from a subscriber perspective. The second thing is, as I mentioned in my comments, there's definitely some conservatism baked in. We've done price increases in the past.

We've never done them this extensive and in some of our very key markets, and so there's some conservatism baked in there. So in general, I think we feel great about the overall subscriber trends over the last 12 months, over the last 9 months, throughout this year and into Q3. And again, when you look at some of the comments I made into the start of the year with respect to both user growth and subscriber growth, we're on pace to exceed kind of the comments I made in terms of similar growth to the prior year. So we feel really good about the trends on both sides.

Bryan Goldberg Executive

All right. We've got time for a few more questions. We're going to go now to Benjamin Black on Marketplace. How is marketplace growth trended and could new products like AI DJ support incremental growth here?

Paul Vogel Executive

So Marketplace has grown really nicely. We haven't updated the numbers in a little while. I think the last time we updated numbers in 2021, it was about EUR 160 million or so of gross profit contribution. I think we said it grew north of 30% last year, and we grew significantly again this year. So Marketplace has continued to grow and be a significant driver.

New -- we're always launching new products. We're always launching different things that we think will benefit our partners, the artists as well as the consumer. So we'll continue to innovate, and we think Marketplace still has a nice trajectory of being additive to also from a financial standpoint, but also more importantly, to the artist community and the benefit they receive from being a participant.

Bryan Goldberg Executive

Okay. We've got a question from Jed Kelly on monthly active users. Can you quantify how much MAUs benefited from the decision to delay price increases versus competitors? And will that benefit dissipate now?

Daniel Ek Executive

Yes. I think you're referring to subscribers growth and not monthly active users because on the free side, I would say we see -- I don't think we have any impact on the price increases on that. But if you think about the subscriber growth again, it may have impacted, it may not have impacted. But again, if we go back and look at the data based on the about 50 price increases we've seen so far. With that data in mind, I would say it has had very little impact on any future growth or anything in terms of churn or conversion rates.

So that's part of the reason why we feel really good about the position we're in and why we feel this is the right time to do this. So my expectation is, while we can't know, of course, is that we don't believe it's meaningfully impacted.

Bryan Goldberg Executive

Okay. Next question from Rich Greenfield on advertising. Ad supported MAUs are growing at over twice the growth rate in your advertising revenues. The ad market is clearly soft. But is there anything else in terms of ad product or advertiser willingness to embrace audio that's dampening your advertising revenue growth?

Daniel Ek Executive

I think, Rich, part of the explanation is really around 2 factors where we are seeing that growth. And then, I would say, a little bit about just the delay in timing. So some of the growth we're seeing in markets that generally don't have the same strength of advertising as say, United States has. So when you think about the rest of the world, obviously, the ARPUs on the ad side are going to be much lower there than they are in the U.S. So that's some of the explanation when you think about ad MAUs growing.

But then the other part is, and I think you can see this as you're looking at all platforms, pretty much all social media platforms follow this similar trend, which is when you have reacceleration of growth or very fast, rapid growth. It usually takes a few quarters before the ad market catches up. . So it is not sort of 1 to 1 when you see a user, you can instantly start monetizing that user. It usually takes a few quarters before you can do that.

And I think you can see that very clearly when you go back and look at some of the other players in the space as well. And I think over time, it will start catching up here, too, but it's more of a lag than anything else. And then, of course, the developing markets part.

Bryan Goldberg Executive

All right. We're going to take our last question today from Benjamin Black on podcasting. Podcast advertising reaccelerated nicely this quarter. What was the source of the turnaround? And more broadly, how would you characterize the advertising environment?

Paul Vogel Executive

So I think there's a couple of things in there. One, SPAN performed really well in the quarter, which helped on the podcasting side. So a lot of it just came from that. It came from improvements in all areas of kind of our ability to deliver on the podcasting side, better sellout rates in general. So that's really what was on the podcasting side.

As I said earlier, the advertising -- podcasting advertising did get better throughout the quarter. So the -- in terms of year-over-year growth rates, the best month was the last month of the quarter for us from a podcasting perspective.

Bryan Goldberg Executive

All right. Thanks, Ben, and that's going to wrap up our Q&A session today. Let's turn the call back over to Daniel for some closing remarks.

Daniel Ek Executive

All right. Thanks, Bryan. It was really a great and historic quarter for Spotify, and I'm 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're also moving faster than ever, and we're better positioned to deliver on our potential and the ambitions we laid out for you at the last year's Investor Day.

We are making tremendous progress towards those goals, and I feel confident about our momentum heading into the second half of 2023. So thank you all for joining us. And as usual, feel free to check out our For The Record podcast, which will be released later today.

Bryan Goldberg Executive

All right. And that concludes today's call. A replay will be available on our website and also on the Spotify app under Spotify earnings call replays. Thanks, everyone, for joining.

Operator Operator

This concludes today's call. Thank you for your participation. You may now disconnect.