

Spotify Executive Summary

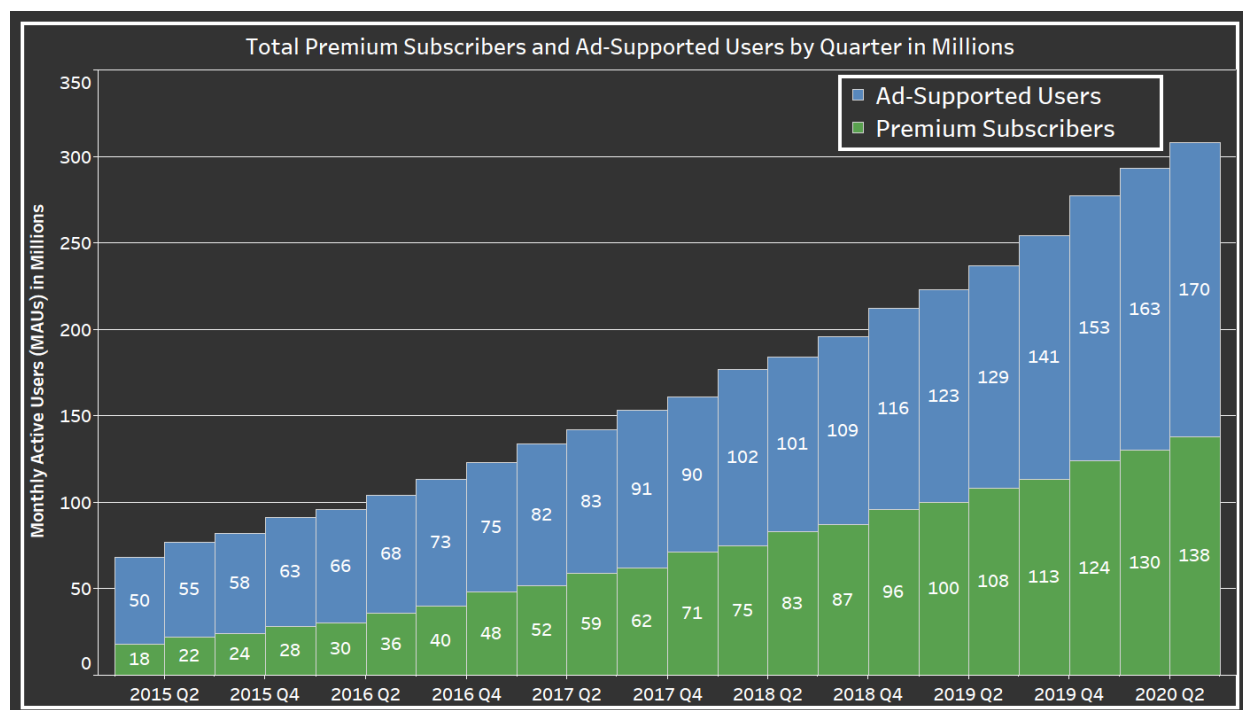
This document describes Spotify's business and monetization strategy, user statistics and KPIs, as well as profitability and share prices since their IPO. Spotify has become one of the world's largest music and podcast streaming services with 299 million monthly active users (MAUs) as of Q2 2020ⁱ across 92 countriesⁱⁱ. The company was launched in 2008 by Daniel Ek and Martin Lorentzon in Stockholm, Swedenⁱⁱⁱ as a music streaming service. It's original purpose was to combat the increasing problem of music piracy^{iv}. The company grew rapidly over the next 10 years and went public on April 3, 2018 as a direct listing, opening up nearly 90% of the shares for trade immediately^v. The company has seen consistent active user and revenue growth quarter over quarter (Q/Q) for the past several years. However, investors became wary due to Spotify's inability to turn a profit until early 2019, and ultimately Spotify operated at a loss for that entire year^{vi} as well as the first two quarters of 2020. Spotify rebounded after an initial dip in usership at the beginning of the COVID-19 pandemic to surpass pre-pandemic levels of users, revenue, and share (SPOT) price.

Business & Monetization Strategy and Active User Growth

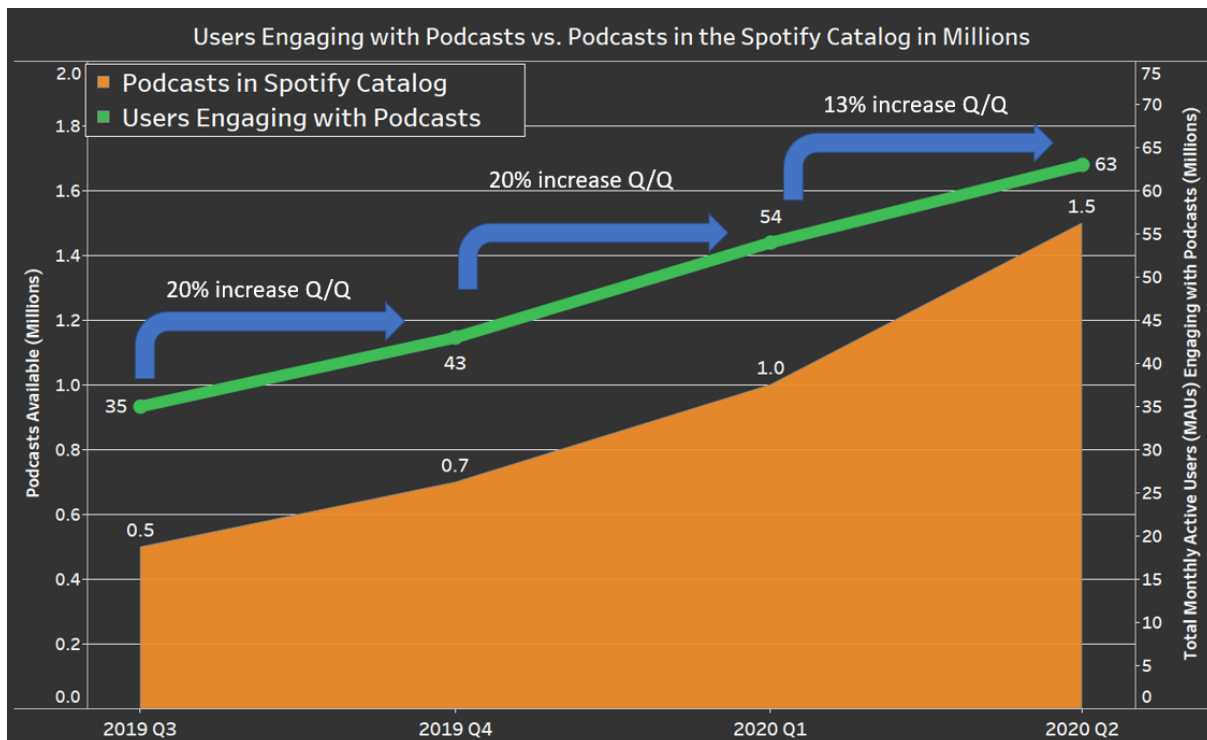
Spotify's monetization strategy is comprised of two services: Premium Subscribers and Ad-Supported Services^{vii}. These services as well as their KPIs are described below.

Premium Subscriptions offer users the ability to listen to unlimited, ad-free music online or offline from Spotify's library of over 50 million songs^{viii}. Spotify offers Premium Subscriptions in 4 distinct plans ranging from \$4.99 – 14.99 per month^{ix}. The company reported 138 million premium subscribers in Q2 2020 resulting in \$2,082M in revenue^x.

Ad-Supported Services offer users a free alternative to Premium with access to a limited catalog. Spotify monetizes these services by selling video, display, and audio ad-space to third parties. Those companies have the opportunity reach the Spotify's critical user demographic ranging between 18-34 years old^{xi}, which comprised 55% of Spotify's customer base as of March 2018^{xii}. Spotify reported 170 million Ad-Supported active users in Q2 2020 resulting in \$155M in revenue^{xiii}. The chart below displays the number of Ad-Supported users (blue) compared to Premium Subscribers (green) for each quarter since 2015, in millions of users^{xiv}.



Spotify has also heavily invested in podcasts over the last couple of years, spending \$415M (current exchange rate) to buy Gimlet Media, Anchor FM, and Parcast in 2019, as well as spending nearly \$250M to acquire The Ringer in February 2020^{xv}. In addition, in May 2020, Spotify acquired exclusive rights to the Joe Rogan Podcast with a multi-year deal valued at \$100M^{xvi} who's podcast reached 190 million monthly downloads in the spring of 2019^{xvii}. Both Ad-Supported Users and Premium Subscribers can engage with podcasts. As the chart below shows, as of Q2 2020, Spotify has a catalog of 1.5 million podcasts and 63 million active users engaging with those podcasts^{xviii}. The chart below displays the number of podcasts (in millions) in the Spotify library (orange) by quarter compared to the number of Spotify active users (in millions in green) who engaged with podcasts during those same quarters. As the blue arrows show, Spotify has seen podcast listeners increase by 20%, 20%, and 13% respectively over each of the last 3 quarters.

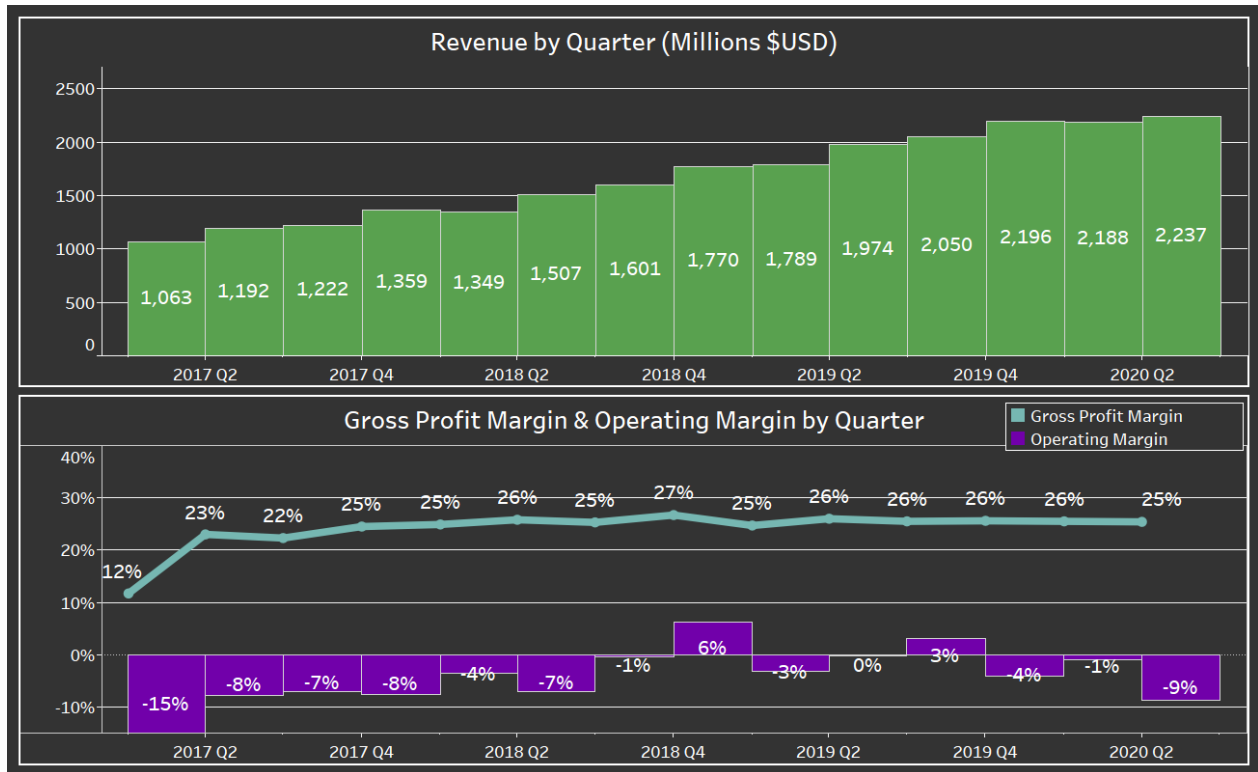


Additional KPI Recommendation

Spotify publishes their monthly average users (MAUs) by region of the world (Europe, North America, Latin America, and Rest of World)^{xix}, but they do not provide user data by country within those four groups. The company also does not publish detailed information on user demographics, such as age. In light of the fact that Spotify's advertising revenue has dropped 21% in Q2 2020 as a result of the impact of COVID-19 on marketing budgets across most industries^{xx}, the organization should be using KPIs such as user by country and age group (i.e. growth rate of users 18-34 years old in the US) as well as users' music and podcast preferences to pitch advertisers on targeted marketing campaigns. Marketing dollars will be scarce for the remainder of 2020 and into 2021 as organizations across most industries cope with the pandemic's impact and getting significant return on investment for their marketing efforts is going to be extremely important. As long as Spotify operates in accordance with the General Data Protection Regulation (GDPR), leveraging their market share of the music & podcast streaming industry and stockpile of user data would help to revitalize their ad revenue stream.

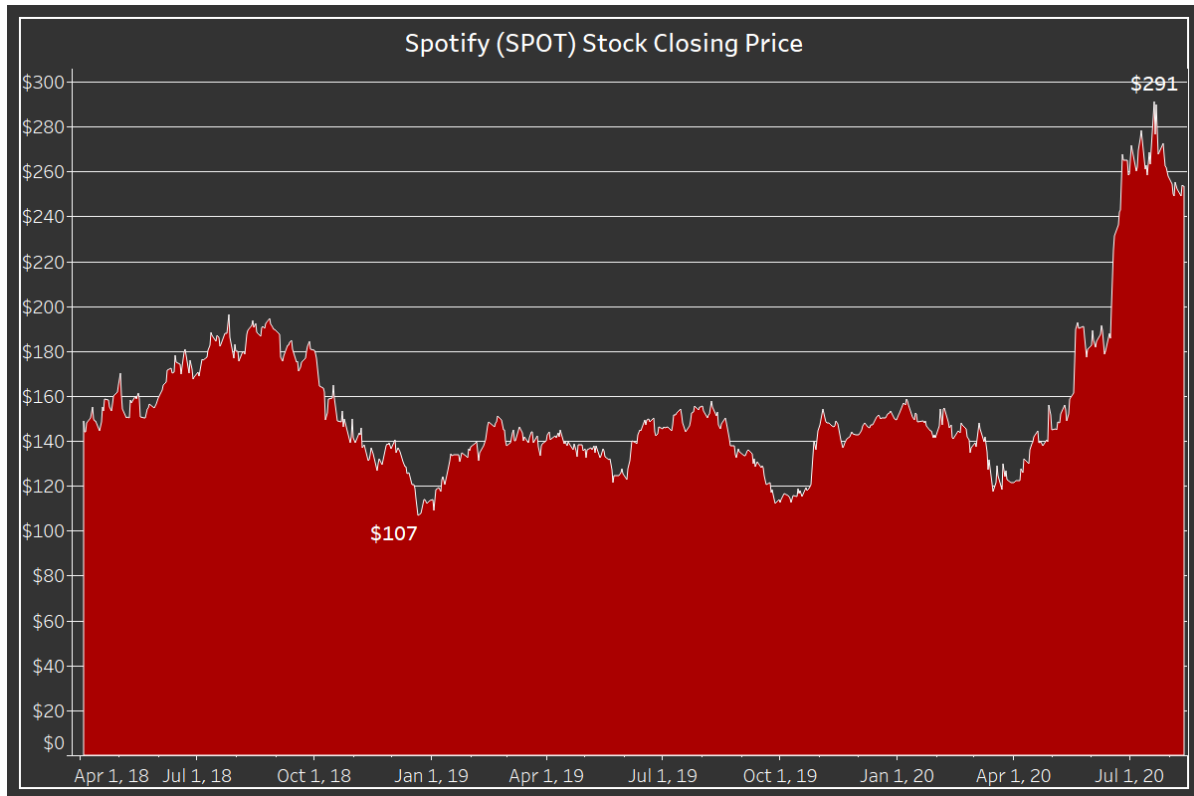
Financial Assessment

Spotify has continued to increase its revenue Q/Q but has struggled to achieve profitability. As the dashboard below shows, Spotify has seen an increase in revenue every quarter since Q1 2018, except for Q1 2020^{xxi}. The company has also consistently had a gross profit margin of 25% or higher since Q4 2017, with a negative operating margin for the majority of quarters since 2017. The low operating margins can be attributed to the costs of music licensing rights, paying record labels^{xxii}, and more recently, Spotify's investment in podcasts. In addition, operating margin in Q2 2020 decreased significantly to -9% due in part to a 21% decrease in advertising revenue^{xxiii}. The green bar chart below shows revenue by quarter in millions, while the line bar chart shows the gross profit margin (light blue) compared to the operating margin (purple) during those same quarters.



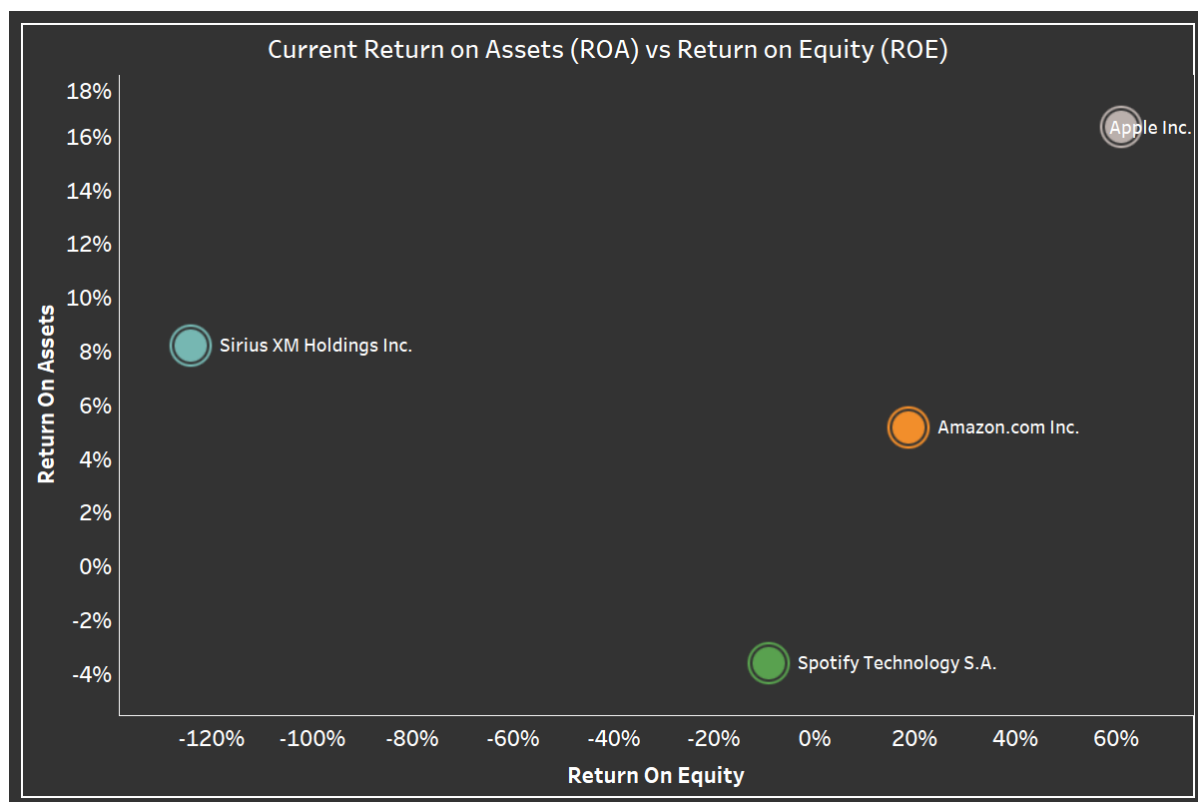
Spotify (SPOT) Share Price Since IPO

After Spotify's IPO on April 3, 2018, the share (SPOT) price showed early promise, rising to over \$190 in July-August 2018 after an close at \$149 in April. From October 2018 to March 2020 it decreased to a rate that consistently fell between \$120 and \$160. As the pandemic took hold across Europe and North America in mid-March 2020, the price began to rise significantly, topping out at a closing price of \$291 per share on July 20, 2020^{xxiv}. According to CNN business, median estimates suggest the 12-month share price forecast will decrease 11.7% with a high estimate of a 14.5% increase in price^{xxv}. Others, such as RBC Capital's Mark Mahaney are more confident in the stock, estimating that it will reach between \$320-\$330 per share^{xxvi}.



Spotify's Return on Assets and Return on Equity

Below is an assessment of Spotify's profitability and corporate effectiveness compared to three of its public competitors: Apple (Apple Music), and Amazon (Amazon Music), and Sirius XM Holdings (owner of Pandora and heavily invested in SoundCloud). Using the Python programming language and financialmodelingprep.com^{xxvii} to pull the data, the chart shows the current return on assets (ROA) compared to the return on equity (ROE) of the four companies. ROA is a company's profitability for every dollar of its assets and ROE shows management's effectiveness in using shareholders' money^{xxviii}. As the graph shows, the ROA and ROE for Spotify are less than 0%, well below Apple at a 16% ROA and 61% ROE, and Amazon with a ROA of 5% and a ROE of 19%. Sirius XM Holdings has a positive ROA but a very low ROE. The company has consistently had a ROE below -50% for the past 18 months^{xxix}. Although this visualization shows Spotify's profitability and corporate effectiveness trail larger competitors, Spotify has successfully raised capital for growth over the past couple of years. It will be important to monitor Spotify's ROA and ROE in the next year to determine how it is progressing toward a consistently profitability.



Conclusion

Despite Spotify's struggles to attain profitability, the company is set up to continue to grow in the near future. Due to its increasing number of users, heavy investments in podcasts, market share, as well as the current state of the global pandemic, there is no indication that Spotify's user base and influence will decrease any time soon, which will most likely lead to a rebound to pre-pandemic levels of ad revenue from clients desperate to achieve a significant ROI from their marketing spend. Spotify forecasts to have between 328M-348M active monthly users by the end of Q4 2020 and there is no reason to believe the company will not reach that level of usership and more in 2021 as their market share continues to grow^{xxx}.

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