

Date: 25/09/2024
Ticker: NYSE:SPOT

Current Price: \$383.96
Target Price: \$410.64

Recommendation: HOLD
Upside: -8.18%

Figure 1: Spotify Historical Share Price (5Y)



Figure 2: Spotify Share Price vs S&P 500 Media & Entertainment Index (1Y)

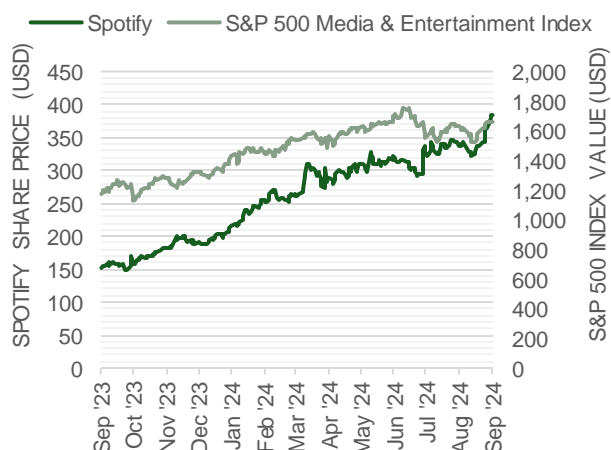


Figure 3: Market Profile (as of 25/09/2023)

Closing Price	\$383.96
52-Week High / Low	\$386.96 / \$145.76
Avg Daily Volume (3M)	1,793,654
Market Cap	\$77.1B
Shares Outstanding	200.81M
Beta	1.58
EV/Revenue	4.51x
EV/EBITDA	115.77x
Institutional Holdings	62.07%
Insider Holdings	25.99%

Source: Yahoo Finance

Executive Summary

Recommendation

We recommend a **Hold** on Spotify (NYSE:SPOT) with a target price of **\$352.55**, based on the consensus of 36 analyst estimates. The current share price of **\$383.96** implies a **short-term downside potential of 8.18%**, indicating that the stock may be slightly overvalued in the near term. While Spotify continues to demonstrate strong revenue growth, with total revenue increasing by 13% year-over-year to €13.25 billion in 2023, its **EBITDA margin remains negative**, and net losses continue to widen. Cash flow has improved, but Spotify must address rising content acquisition costs and improve margins to move toward sustained profitability.

Valuation

Spotify's valuation, based on 36 analyst estimates, suggests a target price range of **\$188.86 to \$511.88**, with a **consensus mean estimate of \$352.55**. The range highlights the uncertainty around the company's future profitability, with investors paying a premium for Spotify's expansion into new markets, podcasts, and ad-supported segments. While these factors support long-term growth prospects, short-term volatility and operational challenges warrant a **Hold** recommendation.

Catalysts

Key **catalysts** that could drive the stock include further expansion into **emerging markets** like Latin America and Southeast Asia, **growth in podcast advertising revenue**, and the potential introduction of new **AI-driven features**. These developments will support user engagement and drive future revenue growth.

Risks

However, critical **risks** include intense competition from **Apple Music, Amazon Music, and YouTube Music**, rising **content licensing costs**, and regulatory challenges in emerging regions. While Spotify has strong growth prospects, it must navigate these risks carefully to justify its current valuation and deliver long-term shareholder value.

Business Overview

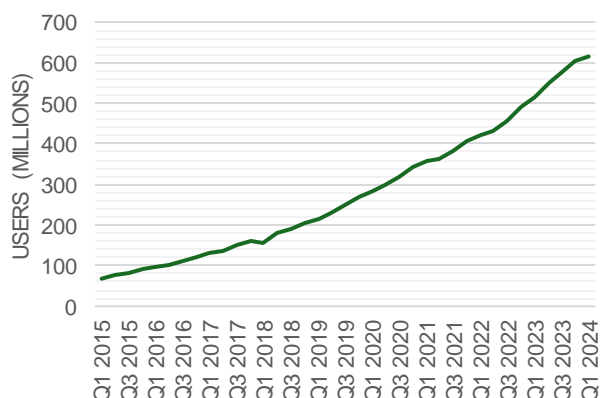
Company Overview

Spotify Technology S.A., founded in 2006 and headquartered in Stockholm, Sweden, is a global leader in the music streaming industry. The company's platform provides users with access to an extensive catalogue of music, podcasts, and other audio content.

Spotify operates a two-tiered business model comprising Premium Subscribers and Ad-Supported Users. While the majority of revenue is driven by its subscription service, Spotify also leverages its large ad-supported user base to generate significant advertising revenue. This dual approach allows the company to cater to a diverse range of users and monetise both direct consumer payments and advertiser relationships.

As of 2023, Spotify boasts over 600 million active users, with around 250 million paying subscribers, solidifying its position as a dominant player in the music streaming industry.

Figure 4: Spotify Monthly Active Users (10Y)



Key Segments

Spotify operates through two segments: **Premium** and **Ad-Supported**.

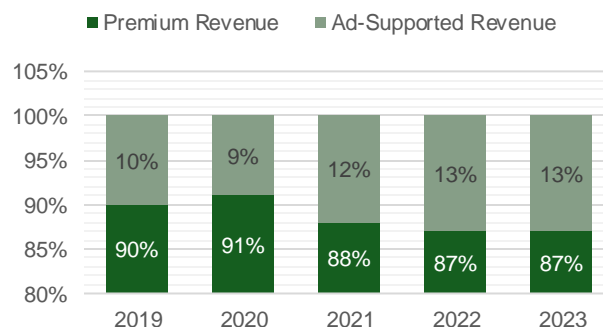
The Premium Subscriber segment comprises users who pay a monthly fee for access to ad-free music, offline listening, and enhanced audio quality. This segment represents the largest portion of Spotify's revenue, contributing significantly through recurring subscription fees. Premium users are crucial to the company's long-term strategy, offering greater profitability due to higher average revenue per user (ARPU) compared to ad-supported listeners.

In contrast, the Ad-Supported segment allows users to access Spotify's vast music library without a subscription, generating revenue through advertisements. Users in this segment experience audio and visual ads, which create revenue through

advertiser partnerships. While ARPU for ad-supported users is lower, this segment plays a vital role in expanding Spotify's user base, providing a wide audience for advertisers, and serving as a conversion funnel for potential premium subscribers.

Together, these two segments offer a balanced mix of revenue streams, enabling Spotify to capitalise on both subscription growth and advertising opportunities.

Figure 5: Revenue Breakdown by Segment (5Y)



Management and Governance

Spotify's management is led by **Daniel Ek**, co-founder and CEO, whose strategic vision has driven the company's expansion into podcasts and innovative features like **Spotify DJ**. His leadership has positioned Spotify as a global leader in streaming, though profitability remains a key challenge.

Paul Vogel, Chief Financial Officer since 2016, has overseen Spotify's revenue growth and user base expansion, but will need to focus on improving margins and managing rising content costs to achieve sustainable profitability.

From a governance perspective, **Christopher Marshall**, Chairman of the Board, ensures strong oversight, though Spotify's dual-class share structure, which gives Ek significant voting control, has raised concerns about shareholder influence. Overall, management's focus on innovation and expansion is strong, but attention must shift towards improving financial sustainability.

Recent Developments

In recent years, Spotify has continued to strengthen its market presence through strategic initiatives and key developments. Notably, the company has expanded its content offering by acquiring podcast production companies, including **Gimlet Media** and **The Ringer**, positioning itself as a leading platform for podcast content. This focus on exclusive podcasts, including high-profile deals such as the partnership with *The Joe Rogan Experience*, has significantly boosted user engagement.

Additionally, Spotify has deepened its partnerships with major artists and labels, enhancing its ability to offer exclusive content. The company has also launched new features such as **Spotify HiFi**, a premium tier aimed at offering higher sound quality to attract audiophiles.

On the technological front, Spotify continues to improve its recommendation algorithms and personalised playlists, most notably with the introduction of **Spotify DJ**, driving user retention and increasing time spent on the platform.

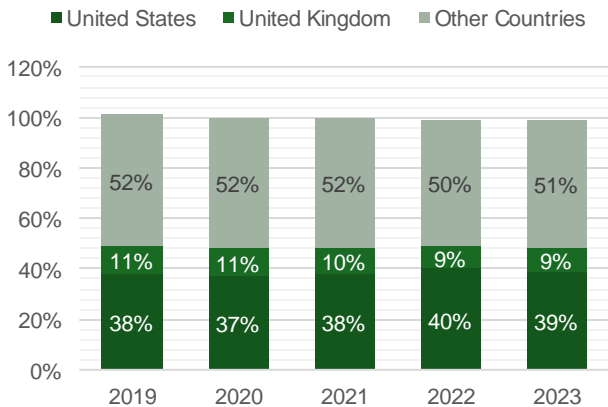
These developments demonstrate Spotify's ongoing efforts to differentiate itself and expand its content ecosystem.

In addition, Spotify has expanded its educational offerings with **Courses**, designed to cater to academic and instructional needs. This initiative further diversifies its user base and enhances content engagement across different demographics.

Geographical Presence

Spotify operates in over 180 countries, with key markets spanning **North America, Europe, and Latin America**. The United States and Europe remain Spotify's largest markets, contributing a significant share of its revenue through high levels of premium subscribers. In these regions, Spotify holds a dominant position, outperforming competitors such as Apple Music and Amazon Music in terms of user base and engagement.

Figure 6: Revenue Breakdown by Geography (5Y)

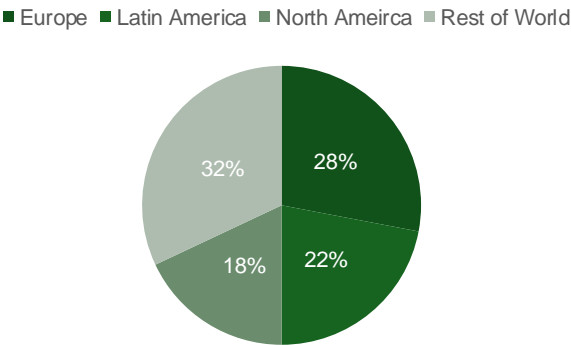


In emerging markets like **India and Southeast Asia**, Spotify has strategically expanded its presence through tailored pricing plans and localised content. These regions present high growth potential due to increasing smartphone penetration and rising demand for streaming services. Although monetisation in these areas remains lower than in more established markets,

Spotify's focus on regional content and partnerships positions the company for long-term growth.

Overall, Spotify's expansive global reach and ability to cater to diverse user bases in both mature and emerging markets reinforce its standing as a leading player in the music streaming industry.

Figure 7: Geographic Distribution of Monthly Active Users (as of Q1 2024)

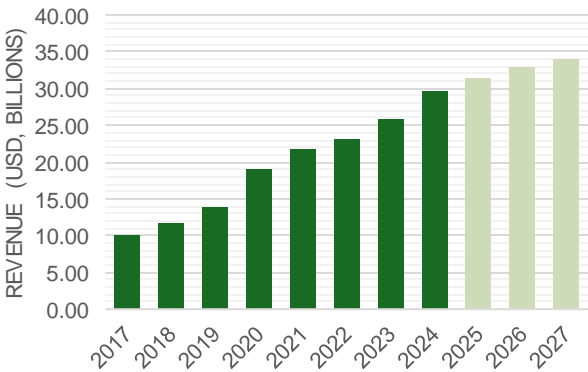


Industry Overview

Industry Trends

The global music streaming market has experienced rapid growth in recent years, driven primarily by increased digitalisation and widespread mobile usage. As consumers shift from traditional media formats to digital platforms, streaming services like Spotify have emerged as the dominant mode of music consumption.

Figure 8: Global Music Streaming Market Size (2017-2027)



This trend is underpinned by several key factors:

- **Mobile Penetration:** The proliferation of smartphones and affordable mobile data plans has significantly contributed to the growth of music streaming, particularly in emerging markets. With improved internet access, users can now stream music on the go, driving up overall consumption.
- **Subscription-Based Models:** The rise of subscription-based services has made music

streaming more accessible and convenient. Companies like Spotify offer users unlimited access to vast music libraries for a monthly fee, contributing to the shift from ownership (physical or digital) to access-based consumption.

- **Podcast Growth:** In addition to music, the increasing demand for podcasts has also been a major growth driver in the industry. Spotify's investments in podcast content, exclusive partnerships, and acquisitions have capitalised on this trend, expanding the platform's audience beyond music listeners.

However, despite the robust growth, the industry faces several challenges:

- **Licensing Costs:** Streaming platforms must navigate the complexities of licensing agreements with record labels and artists. Rising royalty and content acquisition costs put pressure on margins, especially for platforms heavily reliant on premium users.
- **Competition:** The streaming market is highly competitive, with major players like Apple Music, Amazon Music, and YouTube Music constantly vying for market share. This competition pushes platforms to innovate and invest in exclusive content to retain and attract users.
- **Regulation and Copyright Issues:** As music streaming grows globally, platforms must adhere to varying regulatory environments and intellectual property laws, which can affect their operations in different markets.

In summary, the music streaming industry continues to experience dynamic growth driven by technology and changing consumer habits, but faces ongoing challenges related to costs, competition, and regulation.

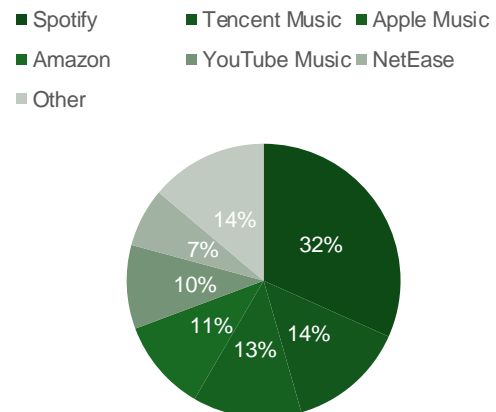
Competitive Landscape

Spotify faces strong competition from **Apple Music**, **Amazon Music**, and **YouTube Music**. Apple Music leverages its ecosystem integration, exclusive releases, and high-quality sound, while Amazon Music benefits from its Prime membership base and Alexa integration, enhancing user retention. YouTube Music, part of the Google ecosystem, combines traditional streaming with user-generated content, appealing to younger audiences. Each competitor capitalises on its ecosystem, making the streaming market increasingly competitive.

Despite this, Spotify remains the global leader with over 600 million active users and 250 million paying subscribers. Its strengths lie in its vast content library,

advanced recommendation algorithms, and strong presence in emerging markets. However, as competitors continue to grow, Spotify must innovate and diversify its offerings to maintain its leadership in the evolving music streaming landscape.

Figure 9: Global Music Streaming Market Share (as of Q3 2023)



Investment Summary

Recommendation and Target Price

We recommend a **Hold** on Spotify (NYSE:SPOT) with a target price of **\$352.55**, based on the consensus of 36 analyst estimates. The current share price of **\$383.96** implies a **short-term downside potential of 8.18%**, suggesting that the stock may be overvalued in the near term. While Spotify's long-term growth outlook remains positive, with analysts forecasting a **34% average growth rate**, the current price reflects limited upside in the short term.

The high-end target price of **\$511.88** presents significant upside potential if Spotify can execute its growth strategy effectively. Conversely, the low-end estimate of **\$188.86** underscores potential risks, including rising content acquisition costs, increasing competition, and regulatory challenges.

Given these factors, we maintain a **Hold** recommendation, recognising Spotify's strong market position and growth prospects, but noting that the stock may need to reach a more attractive entry point before offering better value for investors.

Merits

- **Strong growth in premium subscribers:** Spotify's premium subscriber base continues to expand, with almost 250 million paying users as of 2023. Its tailored pricing strategies in emerging markets and family plans contribute to sustained growth, driving stable recurring revenue.

- **Leadership position in global podcast market:** Spotify has aggressively expanded its podcast offerings, acquiring platforms like Gimlet Media and securing exclusivity deals such as The Joe Rogan Experience. This diversification into podcasts strengthens user retention and creates new monetisation channels.
- **Advanced recommendation algorithm driving user engagement:** Spotify's proprietary recommendation algorithms, powered by AI and machine learning, provide highly personalised playlists like Discover Weekly. This innovation enhances user satisfaction and keeps engagement high, leading to longer time spent on the platform.

Concerns

- **Rising content licensing and acquisition costs:** Spotify's heavy reliance on licensed music from record labels exposes it to increasing royalty and content acquisition costs, which could pressure margins, especially as exclusive content competition heats up.
- **Intense competition from Apple Music and Amazon Music:** Competitors leverage their broader ecosystems (e.g., Apple's integration with iOS and Amazon's Alexa) to lure users, creating a challenge for Spotify to differentiate and maintain user growth in saturated markets.
- **Regulatory risks in emerging markets:** Expanding into regions like India and Southeast Asia introduces regulatory challenges related to data privacy, content censorship, and royalty payments, which could hinder Spotify's growth or increase operational costs.

Catalysts

- **Expansion into new markets (e.g., India, Southeast Asia):** Tailored pricing plans, localised content, and partnerships in these high-growth regions present significant opportunities to increase both user base and premium subscribers.
- **Growth in podcast advertising revenue:** As Spotify's podcast listenership grows, advertising revenues are poised to expand, especially through targeted ads and exclusive shows, contributing to a broader revenue base beyond music streaming.
- **Launch of new features like Spotify HiFi and AI-driven Spotify DJ:** Spotify has the potential to develop new AI-powered tools that

enhance the user experience, building on the success of features like Spotify DJ. Innovations could include real-time playlist generation based on user mood, voice-interactive song discovery, or AI-curated live audio sessions, offering users deeper personalisation and driving higher engagement.

Financial Analysis

Revenue Growth

Spotify's total revenue grew from **€11.73 billion in 2022** to **€13.25 billion in 2023**, representing a year-over-year growth of approximately **13%**. The **Premium Subscriber** segment remains the dominant revenue driver, contributing **€11.57 billion in 2023**, up from **€10.25 billion in 2022**. Meanwhile, the **Ad-Supported** segment saw an increase from **€1.48 billion in 2022** to **€1.68 billion in 2023**, reflecting Spotify's continued success in monetising its free user base through advertising.

Profitability

Spotify's profitability continues to face challenges:

- The **EBITDA margin** improved slightly, moving from **-5.56% in 2022** to **-1.22% in 2023**, but still remains negative.
- The **net income margin** remains negative, at **-19.03% in 2022**, worsening to **-21.61% in 2023**, indicating ongoing struggles with high operating expenses, particularly content costs.
- **Gross profit margins** improved slightly, increasing from **25.95% in 2022** to **26.03% in 2023**, showing some cost-efficiency gains.

Subscriber Metrics

Spotify's **Premium Subscriber** segment remains the dominant source of revenue, contributing approximately **87.6%** of total revenue in 2023, while the **Ad-Supported** segment accounted for **12.4%**. Premium revenue grew from **€10.25 billion in 2022** to **€11.57 billion in 2023**, while ad-supported revenue increased from **€1.48 billion** to **€1.68 billion** in the same period.

Geographic Revenue Analysis

Spotify's revenue distribution highlights its stronghold in developed markets, while emerging regions offer promising growth opportunities.

- **North America** remains Spotify's largest market, generating **€5.23 billion** in revenue in 2023, representing **39.5%** of total revenue. Growth in the U.S. and Canada has stabilised, but high ARPU in this region continues to make it a critical market.

- **Europe** contributed **€4.71 billion** in revenue (35.5% of total revenue) and remains a strong market due to high adoption rates, though growth is slowing.
- **Emerging Markets**, including **Latin America** and **Southeast Asia**, represent significant growth potential. Combined, these regions contributed **€1.68 billion** in 2023 (approximately 12.7% of total revenue). Spotify has implemented tailored pricing strategies and localised content to tap into these high-growth markets, where user acquisition remains strong.

Spotify's **ARPU** in emerging markets remains lower than in developed markets, but subscriber growth rates in these regions are significantly higher, indicating substantial long-term potential.

Cash Flow and Liquidity

Spotify's cash flow from operations improved from **€259 million in 2020** to **€680 million in 2023**, reflecting better cash generation despite rising content costs. However, **levered free cash flow** only marginally improved from **€157 million in 2020** to **€673 million in 2023**, indicating the need for better operational efficiency.

Liquidity remains a challenge:

- The **current ratio** improved slightly from **0.82 in 2020** to **1.29 in 2023**, reflecting a stronger liquidity position.
- The **quick ratio** also saw an improvement, rising from **0.67 to 1.19**, suggesting the company is in a better position to meet its short-term liabilities.

Balance Sheet and Financial Health

Spotify's debt levels remain manageable, with a **total debt-to-equity ratio** improving from **21.68% in 2020** to **15.09% in 2023**. The company's **net debt** improved further, from **€863 million in 2020** to **€680 million in 2023**, indicating a reduction in debt and increased cash reserves.

Valuation Multiples

Spotify's valuation multiples reflect its growth potential, but also its profitability struggles:

- **Enterprise Value to Revenue (EV/Revenue)** was **3.90x** in 2023, down from **6.57x** in 2020, reflecting growing concerns about profitability but maintaining investor optimism due to long-term growth potential.
- **Price-to-Book (P/B)** remained elevated at **17.07x** in 2023, indicating a premium valuation based on the market's expectations of future

growth, especially in the podcast and ad-supported segments.

- **Price-to-Earnings (P/E)** was not meaningful in 2023, as net losses persist, signalling the company's ongoing struggle with profitability despite its revenue growth.
- **Enterprise Value to EBITDA (EV/EBITDA)** was also not meaningful in 2023, further emphasising the challenges Spotify faces in converting revenue into positive earnings.

Spotify's high EV/Revenue and P/B multiples reflect investor confidence in its long-term growth, particularly in new markets and the ad-supported segment. However, the lack of meaningful earnings and EBITDA multiples highlights profitability concerns. To justify its elevated valuation, Spotify must improve cost management and generate profits. In the short term, volatility is likely as investors balance growth potential with ongoing operational challenges.

Financial Summary

Spotify's financial performance reflects **strong revenue growth**, particularly driven by its premium subscriber base, which remains the core of its business model. However, **profitability remains elusive**, with ongoing struggles to contain operating costs and improve margins. To move towards profitability, Spotify must prioritise **breakeven targets** in its **ad-supported segment** and focus on **reducing content acquisition costs** through renegotiations and improved licensing efficiency. While **cash flow has shown some improvement**, the company's liquidity position highlights the need for more efficient capital management. Geographically, its established markets in North America and Europe continue to provide stability, while emerging regions like Latin America and Southeast Asia offer significant untapped potential. Overall, while Spotify continues to expand its global footprint and user base, its journey to **sustainable profitability** will require **tighter cost controls** and **strategic investments** in high-growth regions.

Investment Risks

Regulatory Risks

As a global company, Spotify is subject to varying **data privacy regulations** and **content licensing laws** across different regions. Potential regulatory challenges include stricter data protection laws such as the **GDPR** in Europe, which could increase compliance costs or limit Spotify's ability to collect and monetise user data. Additionally, potential future regulations around content moderation and copyright enforcement could limit Spotify's ability to expand its podcast offerings or impose fines for non-compliance.

Market Risks

Spotify faces intense competition from **Apple Music**, **Amazon Music**, and **YouTube Music**, all of which benefit from deep integration into broader ecosystems. Apple Music, for example, is tightly linked to the iOS ecosystem, while Amazon Music offers benefits through its Prime membership, making it easier for these services to retain users. This competitive landscape could pressure Spotify to increase spending on marketing and exclusive content to differentiate itself, potentially squeezing margins.

Operational Risks

Spotify’s business model is highly dependent on **content licensing deals** with major record labels. Rising content acquisition costs can place downward pressure on margins, especially as the company seeks

to expand its podcast and music catalogue. Additionally, there’s a risk that Spotify’s reliance on third-party content could limit its bargaining power in future licensing negotiations, further eroding profitability.

Economic Risks

As a subscription-based service, Spotify is vulnerable to **macroeconomic trends** that affect consumer spending. In times of economic downturn, discretionary spending may decrease, leading to lower subscription renewals and slower growth in premium subscribers. Additionally, rising inflation and interest rates could affect the cost of doing business, leading to higher operational expenses and tighter margin

Figure 10: Key Investment Risks and Mitigation Strategies

Risk	Mitigation
Data Privacy and Licensing Regulations	Invest in strong compliance teams and adopt transparent data privacy practices. Engage in strategic lobbying and partnerships with regulatory bodies.
Intense Competition from Apple, Amazon, YouTube	Innovate through AI-driven features (e.g., Spotify DJ) and exclusive podcast content to differentiate. Expand presence in emerging markets to reduce saturation.
Rising Content Acquisition Costs	Diversify content with exclusive podcasts, user-generated content, and long-term licensing deals. Focus on proprietary content to reduce reliance on third-party.
Macroeconomic Pressure on Subscriptions	Offer flexible pricing tiers in emerging markets and focus on the ad-supported segment to offset premium subscriber losses during economic downturns.

Disclaimer

This report (“Report”) has been prepared by Veritage Capital (“Firm”) exclusively for internal purposes in relation to an analysis of Spotify Technology S.A. The information contained herein has been obtained from sources that the Firm believes to be reliable; however, the Firm does not represent or warrant, either expressly or implied, the accuracy, completeness, or timeliness of such information. All figures, analyses, and projections contained within this Report are provided for informational purposes only and should not be relied upon as the basis for any investment decision. The Report does not constitute an offer or solicitation to purchase, sell, or hold any securities and should not be construed as financial, legal, or investment advice. The conclusions drawn herein are based on current market conditions and are subject to change without notice.

Investing in securities involves substantial risk, including the possible loss of principal. All investment decisions should be made based on individual circumstances and thorough due diligence. Past performance is not indicative of future results, and no assurances can be given regarding the future performance of any financial instrument or security discussed in this Report. This Report is confidential and intended solely for the internal use of the recipient. Any reproduction, dissemination, or further distribution of this Report, in whole or in part, without the express prior written consent of Veritage Capital, is strictly prohibited. The Firm reserves the right to amend, update, or withdraw the Report at any time without prior notice.

© 2024 Veritage Capital. All rights reserved.