

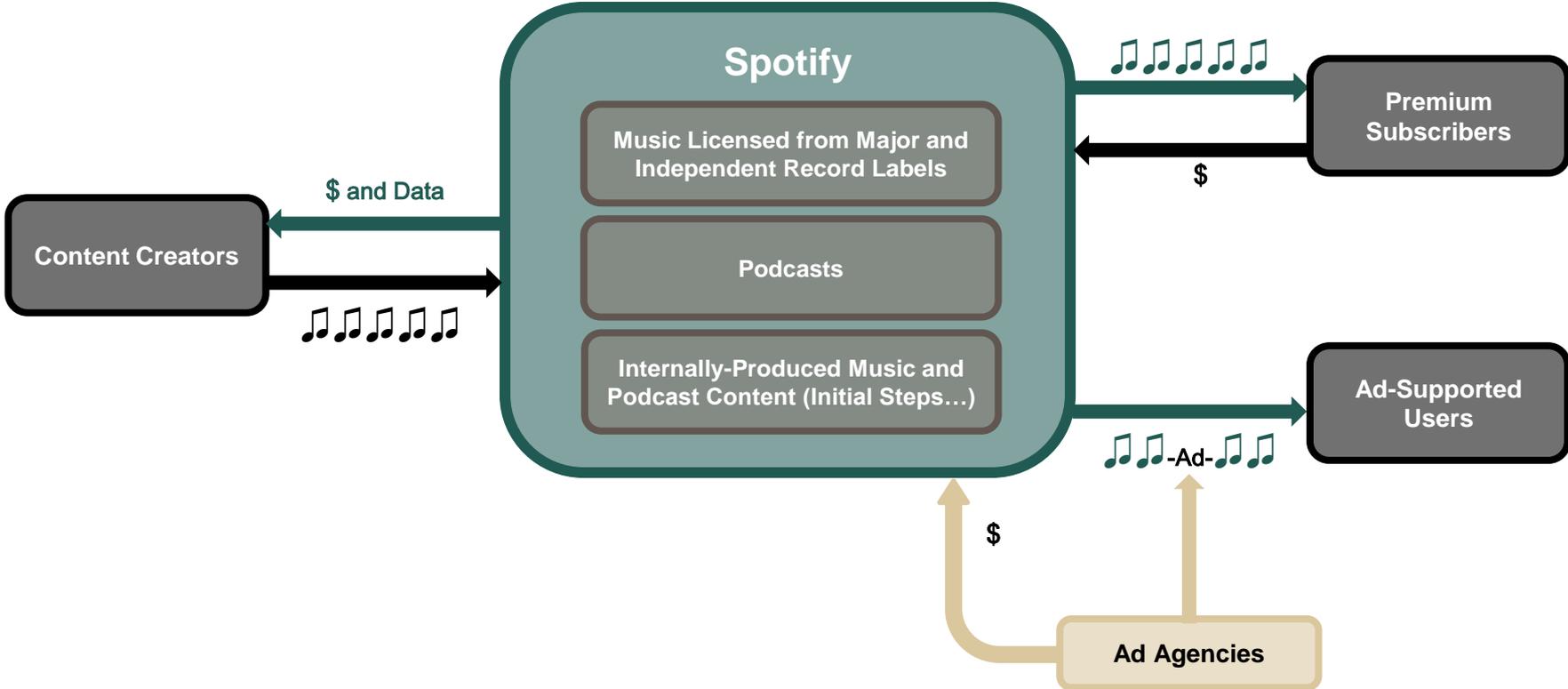


# Summary

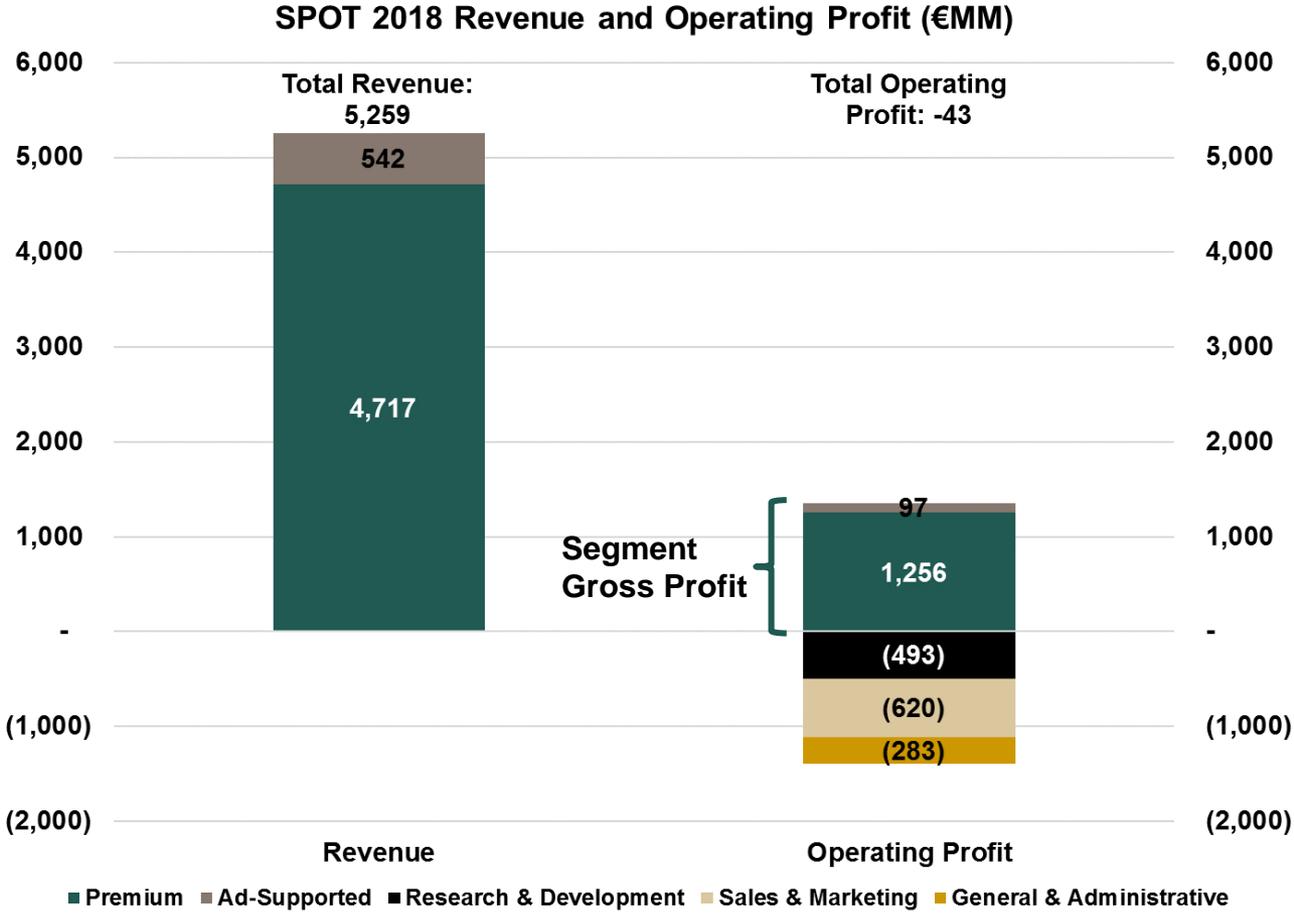
As of 06/07/2019			TTM	4-Year Avg
Price (\$)	140.08	Gross Margin	25.5%	17.7%
Market Cap (\$MM)	25,308	EBIT Margin	-0.8%	-8.5%
EV (\$MM)	22,817	Net Margin	-1.5%	-15.4%
P/E (Last FY)	-			
P/E (Next FY Est)	-			
P/FCF (TTM)	114.9			
P/S (TTM)	3.9			
EV/EBITDA (TTM)	-			
Dividend Yield	0.0%			
Net Debt-to-EBITDA (TTM)	-			
Debt-to-Total Capital	18%			
Rating	Buy/Add			
12-18 Month Price Target	\$184			



# Spotify's Business Model

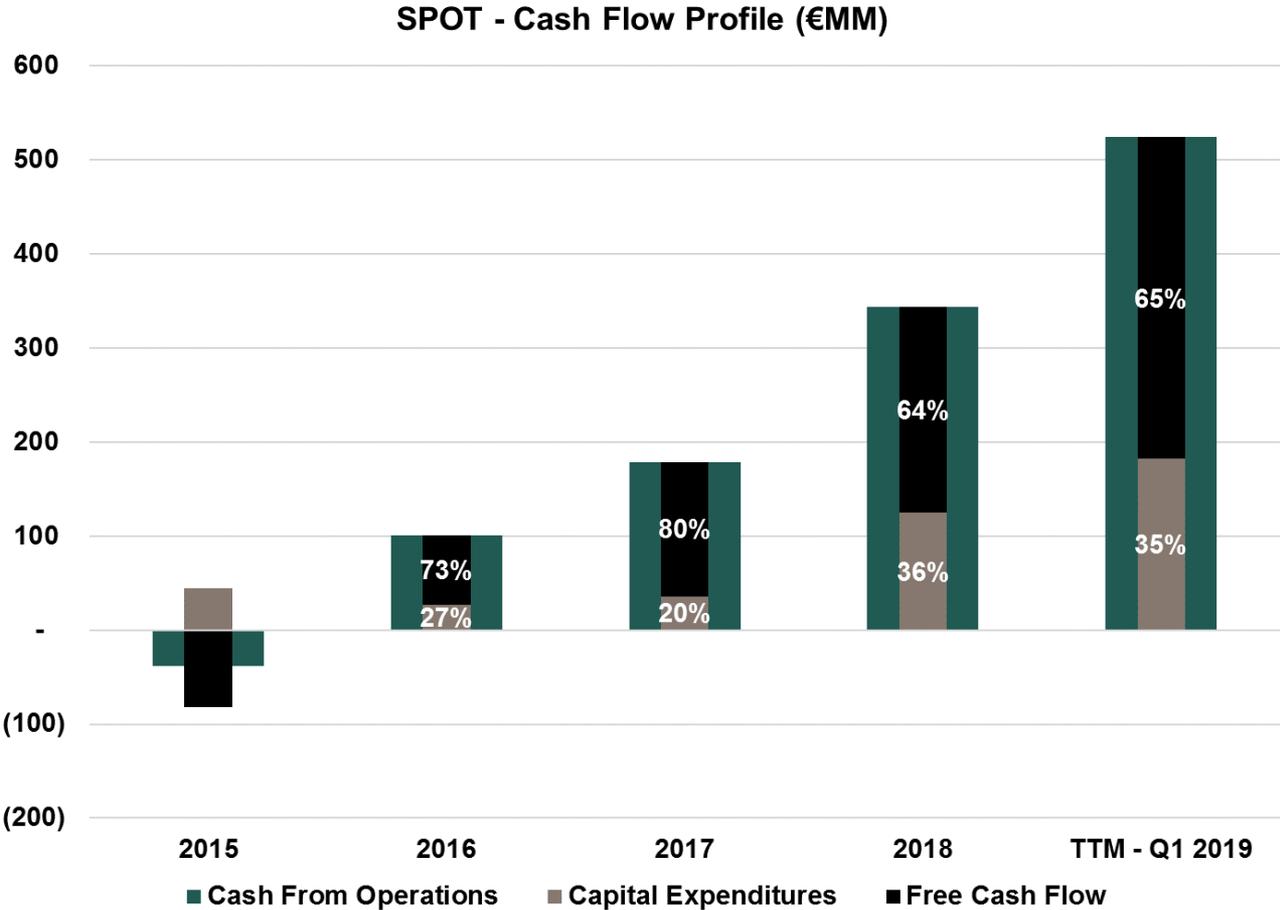


# Business Overview



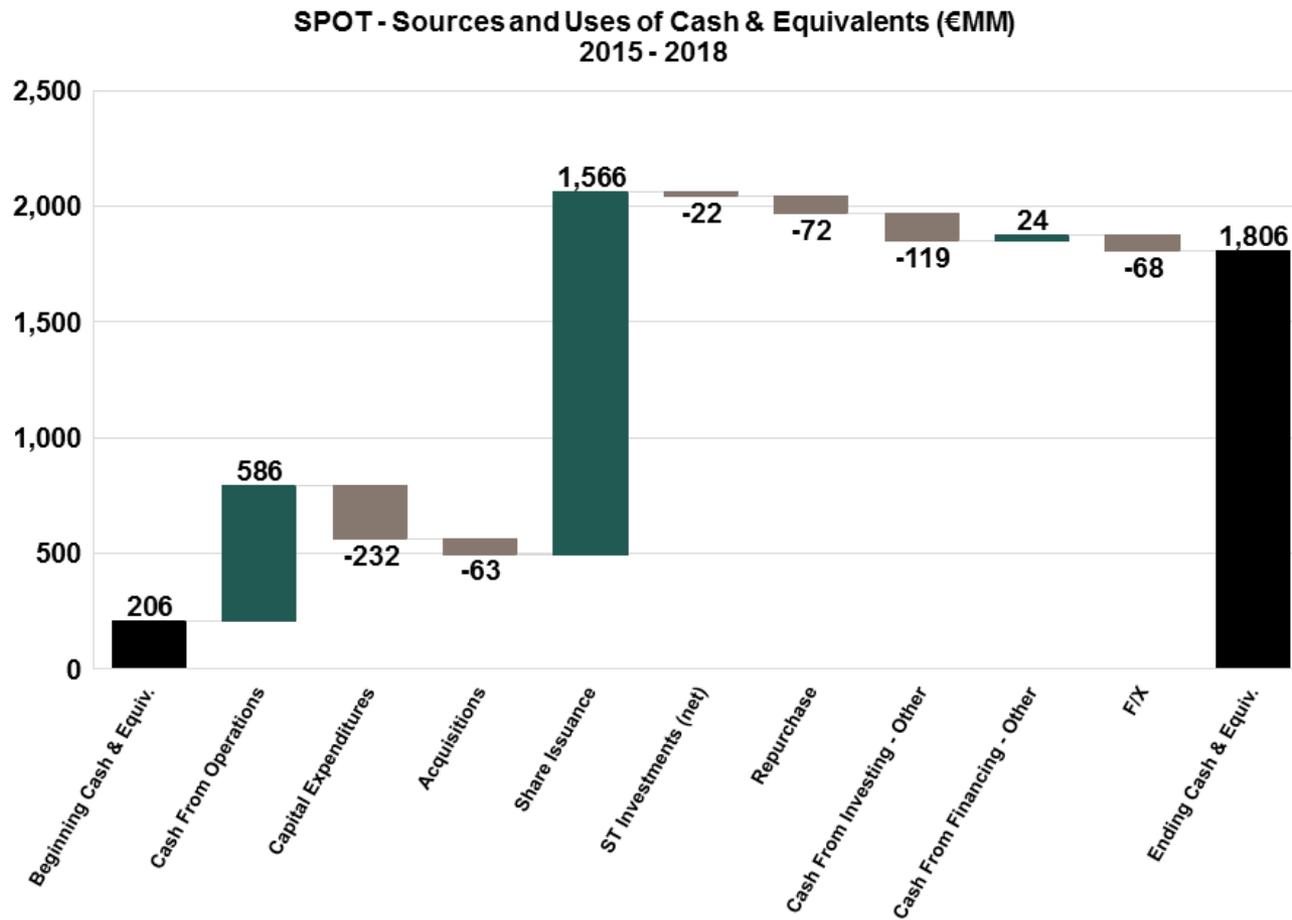
# Free Cash Flow

2015 – 1Q 2019



# Sources and Uses of Cash

2015 - 2018

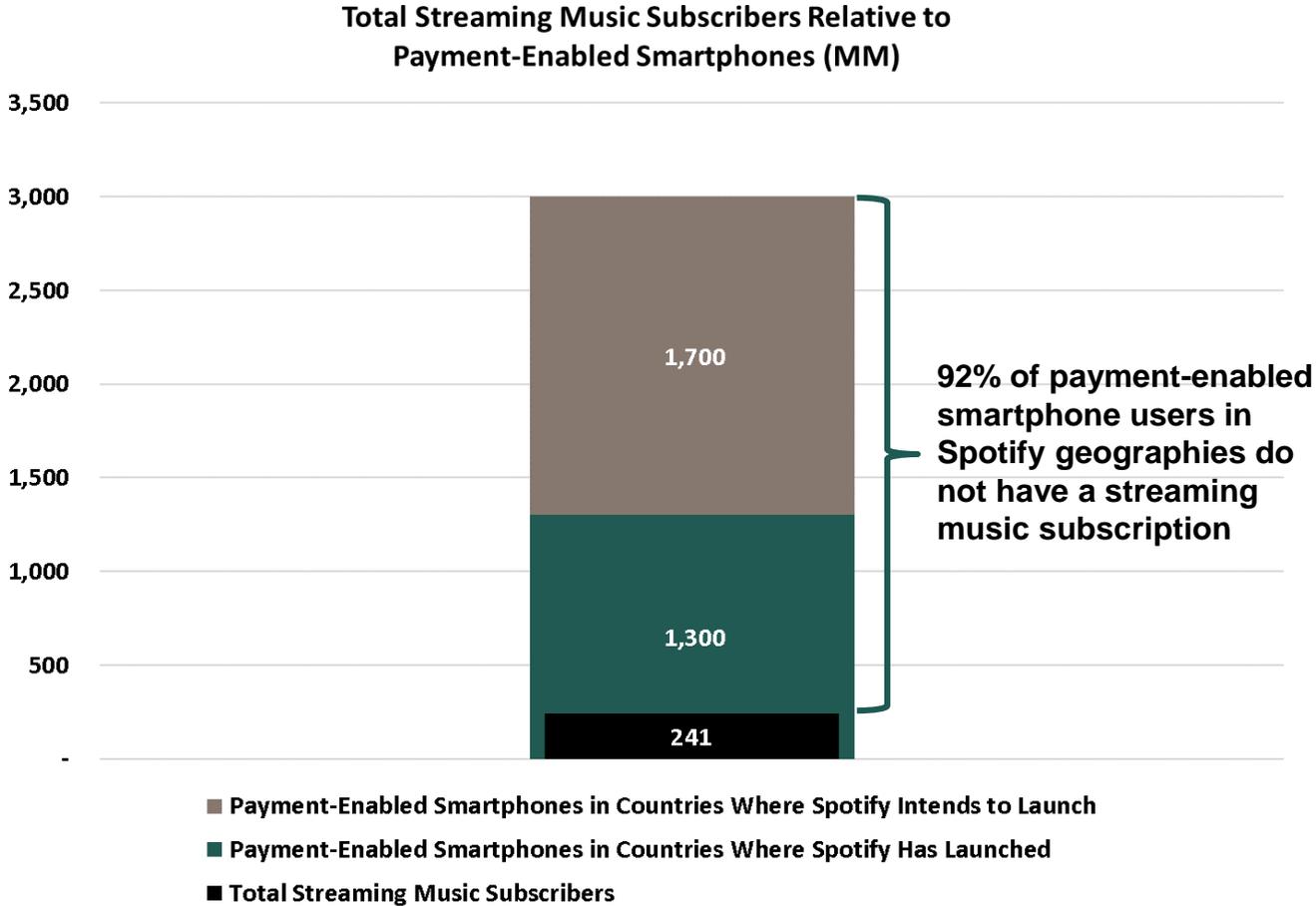


# Why We Think Spotify is a Great Business

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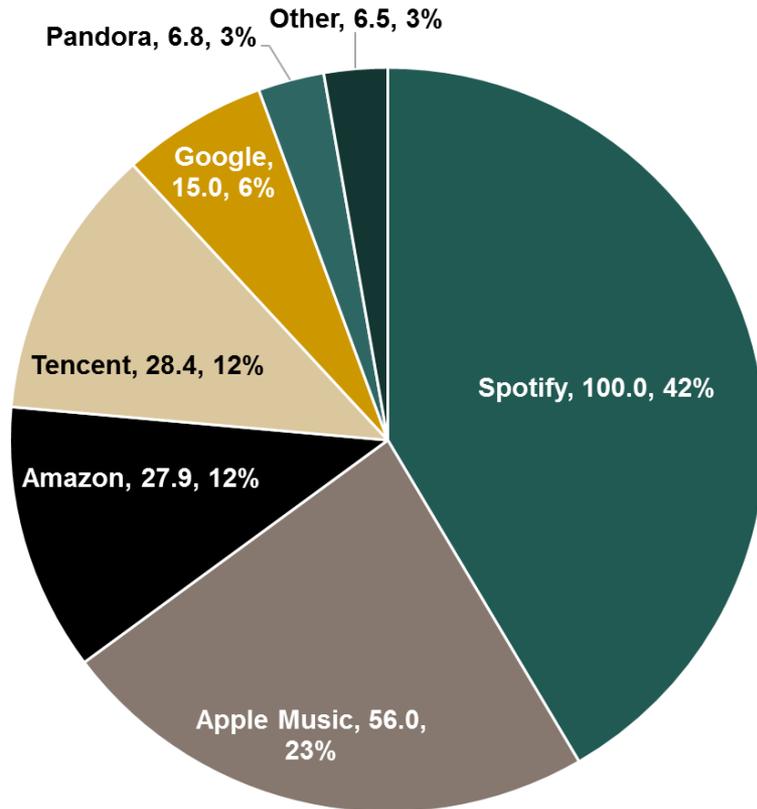
- Spotify is a disruptor in a large and inefficient industry that is resistant to change
- Spotify controls a two-sided network that increases its value to both customers and music industry stakeholders over time
  - Artists benefit from its technology that displaces intermediaries and connects them directly with fans
  - Consumers benefit from curation and discovery
- Spotify is the only competitor at scale with a sole focus on streaming audio
- Spotify generates free cash flow today and has significant opportunity to reinvest future free cash flow

# Subscription Audio Still in Early Stages of Growth



# Spotify is the Market Share Leader

Subscription Music Market Share  
Number of Paid Subscribers (MM) and Market Share (%)



“In 2016 and 2017, we negotiated new label agreements with our four largest label partners. The new rates improved our gross margin by about 700 basis points on a year-over-year basis.”

- Barry McCarthy,  
Spotify CFO  
Investor Day, March 2018

# The Music Industry is Full of Intermediaries

- Citi estimates that artists capture just 12% of the industry's \$43B of annual revenue

To paraphrase, “[Music industry] margin is [Spotify’s] opportunity.”



**Creation (7% of industry revenue)**  
Producers (3%-4% of royalties)  
Mixer  
Studio Musicians

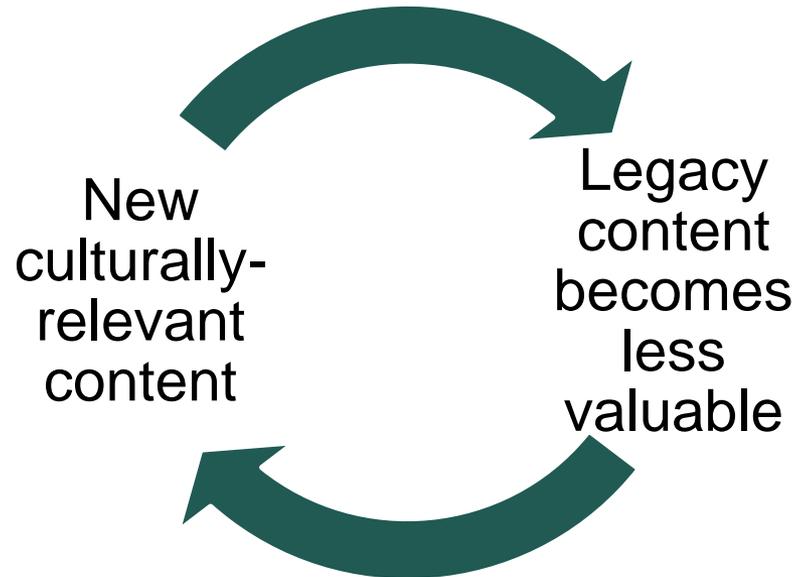
**Consumption (74%)**  
Record Label (80%-87% of royalties)  
• Streaming Rights  
• Album/Song Sales  
Publishing Rights (Songwriters)  
• Performance Rights Organizations (11%)

**Performance (19%)**  
Venues (20%-60% of ticket sales)  
Opening acts  
Promoters  
Crew

Manager  
(15% of gross revenue)  
  
Attorneys  
  
Agents



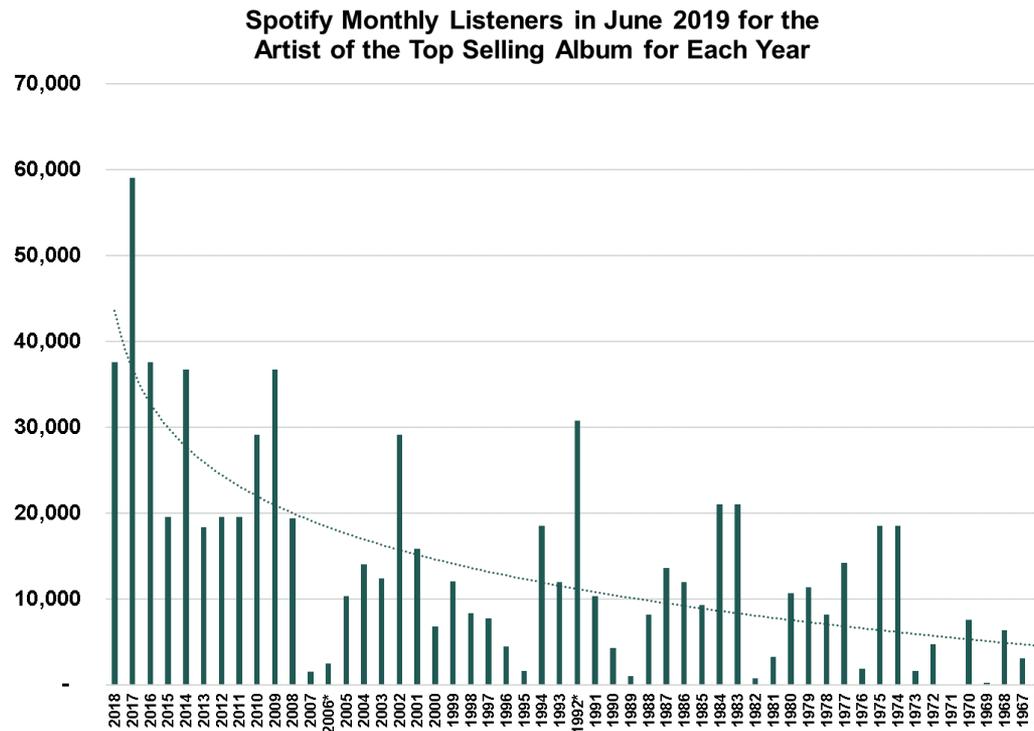
# Erosion of Labels' Competitive Advantage



As technology enables new content to gain cultural relevance without the services of traditional intermediaries, the competitive advantage of record labels erodes

# Erosion of Labels' Competitive Advantage

- The record labels must continually renew their pipeline in order to maintain cultural relevance
- Each year that passes where labels are disintermediated makes the back catalogue less valuable and lessens the strength of their competitive position in the industry value chain

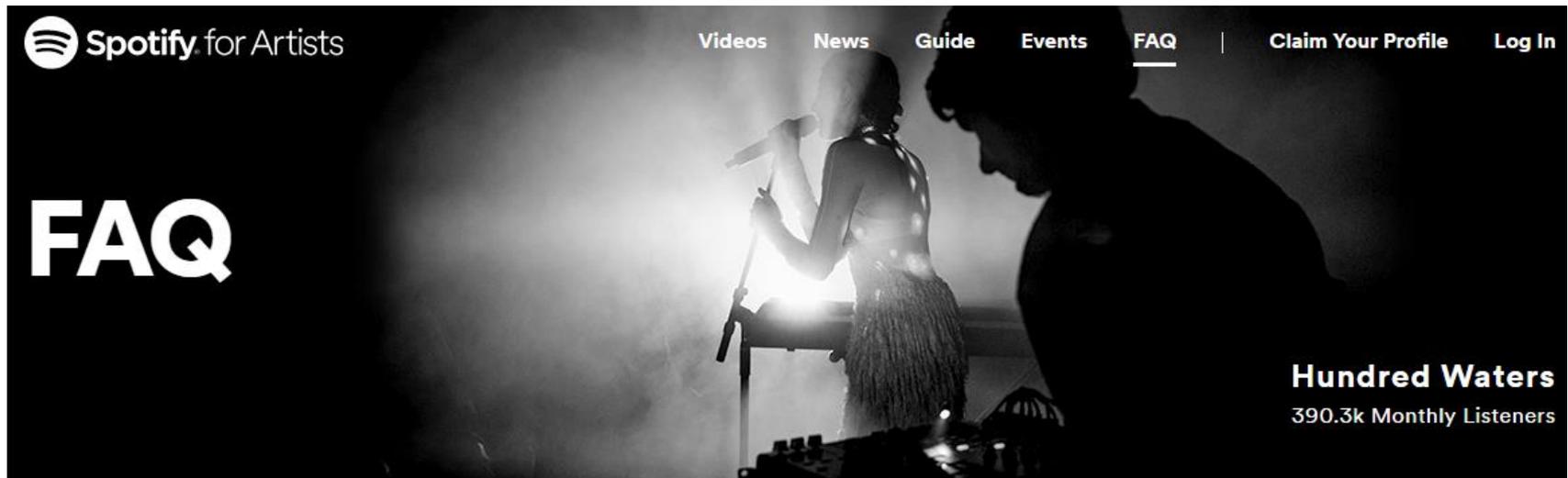


Sources: Spotify (as of June 6<sup>th</sup>, 2019); Billboard; Wikipedia

\* 2006: top-selling album was the soundtrack to High School Musical, with no single high profile artist; numbers reflect monthly listeners of the soundtrack

1992: top-selling album was by Billy Ray Cyrus, who is enjoying a near-term resurgence due to his singing on a remix of 'Old Town Road' and whose monthly listener count was likely significantly lower prior to this song's release

# Spotify Improves Economics for Artists



POPULAR ACCESS MUSIC PROFILE STATS CONCERTS PROMOTION UPLOAD BETA MASTERING & LOUDNESS

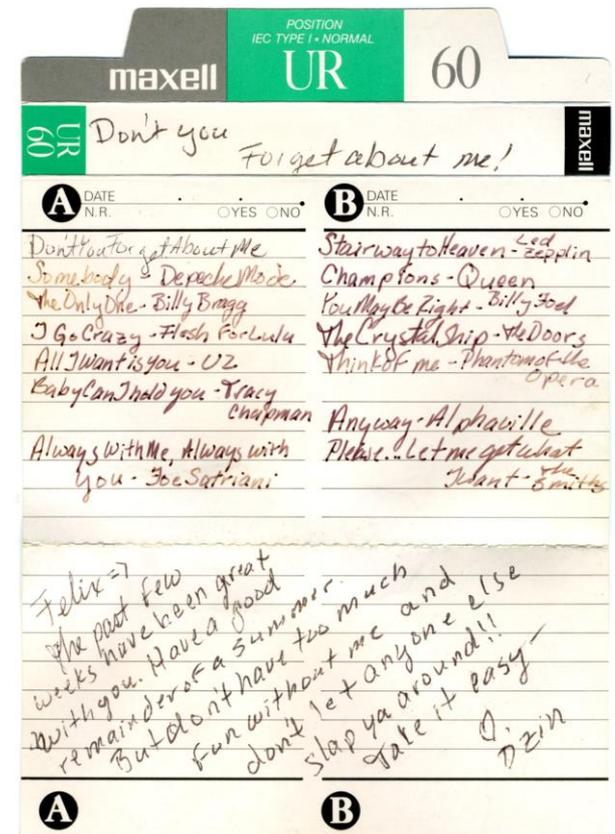
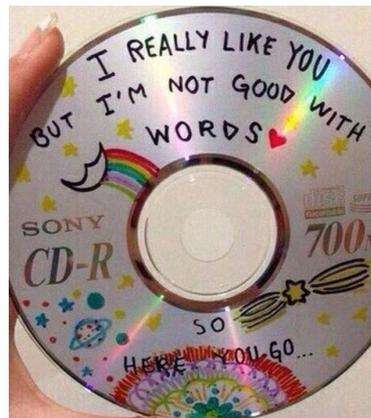


Each of these areas have significant opportunity for reinvestment in order for Spotify to become more vertically integrated in the music industry and improve gross margin

# Music is Inherently Social

## Curation and Discovery Matter

Whether the curation is professional.....or personal



# Spotify Understands Curation



- 30% of music streamed on the service is curated by an editorial team or algorithm
- Spotify's RapCaviar playlist is an example of its understanding of the importance of curation and the Spotify's cultural relevance
- The playlist has over 11MM followers
- Making the playlist can make an artist's career
  - “The most influential playlist in music is Spotify's RapCaviar, which turns mixtape rappers into megastars.”, Vulture (New York Magazine's Pop Culture Site)
- Since 2017, Spotify has produced live concerts based on the brand throughout the U.S. and Canada

# Competition Has a Secondary Focus on Music



amazon



- Allocating capital to music streaming (a 'nice to have') takes resources away from high-return investment in core businesses
- Competitors prioritize general music consumers over fans or artists
  - In April, Google shut down its Google Play Artist Hub and forced musicians to a non-fully featured YouTube music or to make their music available via a distributor

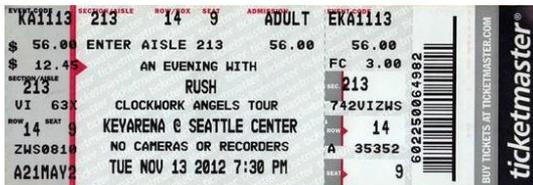
“In a world where the catalog can be found anywhere, value shifts to discovery.”

- Gustav Söderström,  
Spotify Chief R&D Officer

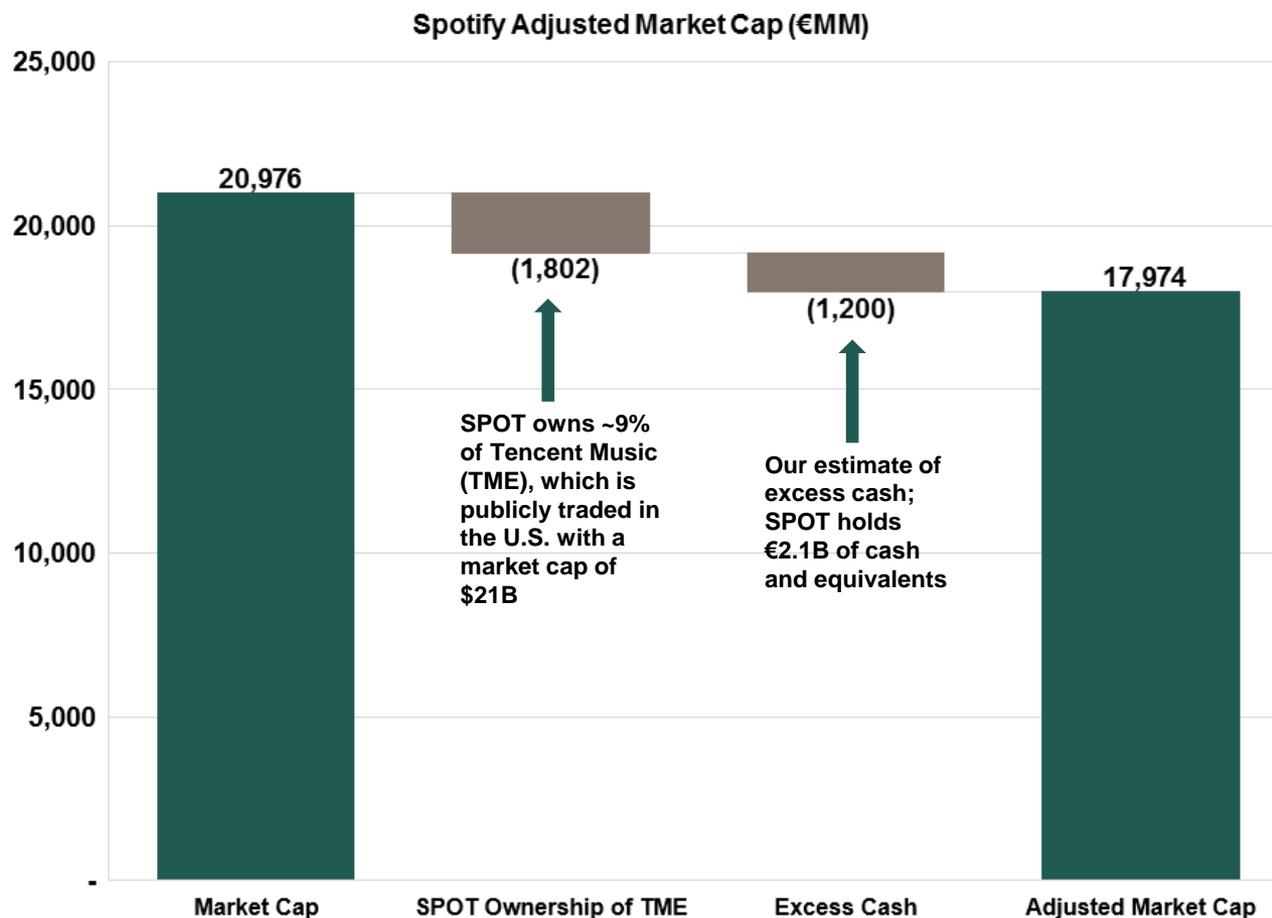
# Areas for Additional Investment



- Podcasts and original content
  - Reduce churn by increasing engagement and offering exclusive content
- Tickets and merchandise
  - Displace intermediaries by directly targeting fans with special deals and unique experiences
- Data and Analytics
  - Increase gross margin by providing additional artist services



# Valuation – Adjustments to Market Cap as of 06/07/2019



# Valuation

## Subscriber Model to Value Current Business

- The current business trades near fair value using the long-term assumptions highlighted below
- Our analysis concludes there is a high probability that favorable dynamics for both Spotify and the streaming music industry would allow several or all of the key valuation drivers for the current business to exceed these long-term assumptions to the upside

↓

	Current	2020 (Est)	Long-Term (5+ Years)	Reasons We Believe Upside Over Long-Term Assumptions is Realistic
Premium MAUs (MM)	96	138	250	<ul style="list-style-type: none"> <li>• Individuals with payment-enabled smartphones (potential subscribers) expected to grow 10% annually to 1.7B by 2021</li> <li>• 1.3B payment-enabled smartphones in countries where Spotify has not launched</li> <li>• 250MM MAUs at current market share implies 600MM globally paying for subscription music (46% of 2018's payment-enabled smartphones) and no geographic expansion</li> <li>• Network effect should allow Spotify to increase market share</li> </ul>
ARPU (€ monthly)	4.71	5.00	6.00	<ul style="list-style-type: none"> <li>• ARPU depressed due to launches of Student and Family plan</li> </ul>
Average Monthly Churn	3.75%	3.75%	2.00%	<ul style="list-style-type: none"> <li>• A music library is personal – individuals who have spent time and effort curating their own library are unlikely to switch</li> </ul>
Adjusted Gross Margin	28.68%	32.00%	35.00%	<ul style="list-style-type: none"> <li>• Removing intermediaries will allow artists to be paid more while Spotify captures higher gross margin</li> </ul>
Lifetime Value of a Sub (€)	23	27	75	
LTV / SAC	2.78	2.70	7.49	
Adjusted Market Cap / Sub (€)	188	131	72	
Premium / (Discount)	720%	385%	-4%	



# Valuation

## Upside Potential From Expansion into New Businesses

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# Key Risks

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- Inability to secure rights to and/or to control the cost of third-party content
- Unfavorable changes to regulation related to music licensing and royalty payments
- Failure to gain adoption of its offerings for artists, limiting gross margin expansion and leading Spotify to compete with others based solely on the catalog (race to the bottom)
- Failure to differentiate its service from competitors, leading to lower engagement and higher churn
- Spending beyond its means to acquire or develop original content
- Inability to grow and/or operate profitably in segments outside of its core streaming business

# Summary

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- Spotify is a high quality business with sustainable competitive advantages
  - Spotify is a disruptor in a large and inefficient industry
  - Artists benefit from its technology that displaces intermediaries and connects them directly with fans
  - Consumers benefit from curation and discovery
  - Spotify's competitors are focused on giving consumers access to a library rather than building a platform that serves artists and curates for consumers
- Spotify has significant opportunity to reinvest its free cash flow to grow the business
  - Podcasts and original content
  - Data and analytics
  - Further displacing intermediaries by vertically integrating into the industry
- In our view, the assumptions implied in the market's valuation of Spotify's current business are very achievable and likely to surprise to the upside
- We see further upside to valuation from these reinvestment opportunities and its holding in Tencent Music

# Appendix



The Strength of Advice®

# Why Audio is Different than Video

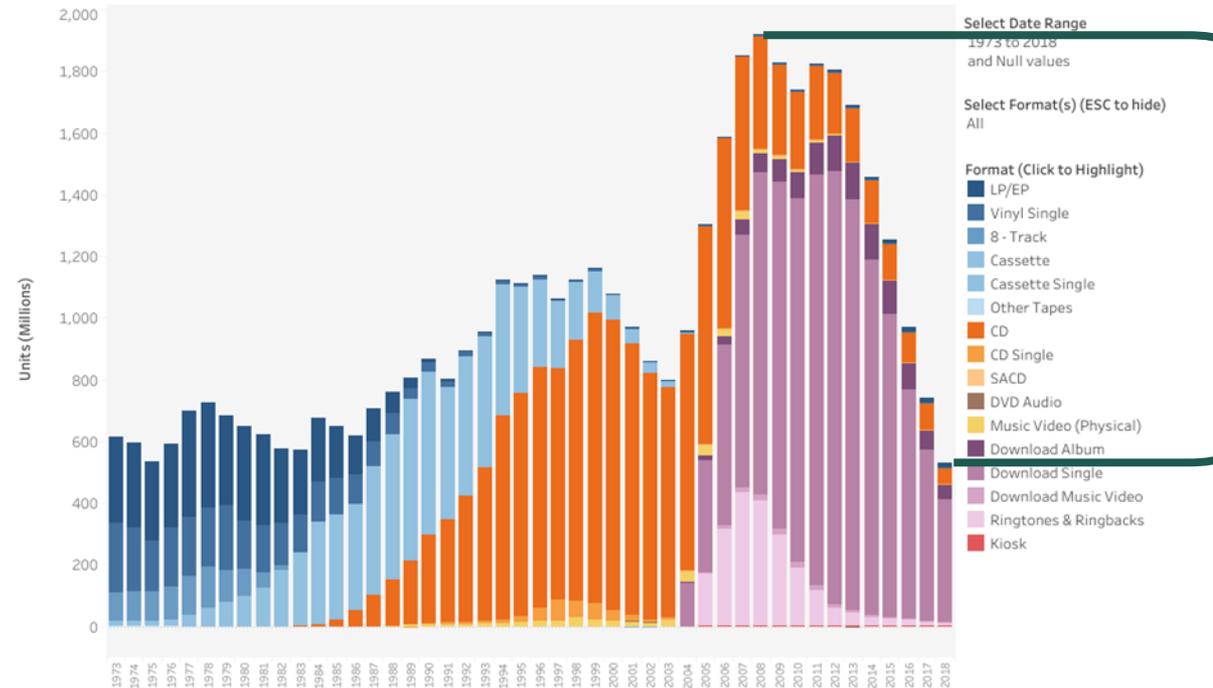
	Audio	Video
Availability of Content	Entire library must be available <ul style="list-style-type: none"><li>• Songs are listened to repeatedly</li><li>• Individuals curate their own libraries, so multiple services with varying content is not realistic</li></ul>	Comprehensive library not required <ul style="list-style-type: none"><li>• Most users do not consume video content repeatedly</li><li>• A subscriber does not require immediate access to content once watched</li></ul>
Attention Span	Audio can be consumed while doing other things <ul style="list-style-type: none"><li>• More hours in the day available for consumption</li></ul>	Video requires complete attention
Technology Requirement	~150MB per streaming hour	SD: ~1GB per streaming hour HD: 2-3GB+ per streaming hour

# Volume of Record Sales Has Declined...

## U.S. Recorded Music Sales Volumes by Format

1973 to 2018, Format(s): All

Source: RIAA



Source: RIAA. Permission to cite or copy these statistics is hereby granted, as long as proper attribution is given to the Recording Industry Association of America

**70% decline in domestic recorded music sales volumes since 2008 peak (including digital sales)**

- Kiosk includes Singles and Albums
- Ringtones & Ringbacks includes Master Ringtones, Ringbacks, and prior to 2013 Music-Videos, Full Length Downloads, and Other Mobile
- Subscription includes streaming, tethered, and other paid subscription services not operating under statutory licenses.
- Subscription volume is annual average number of subscriptions, excludes limited tier
- Other Tapes includes reel-to-reel and quadraphonic
- Total units excludes Paid Subscriptions

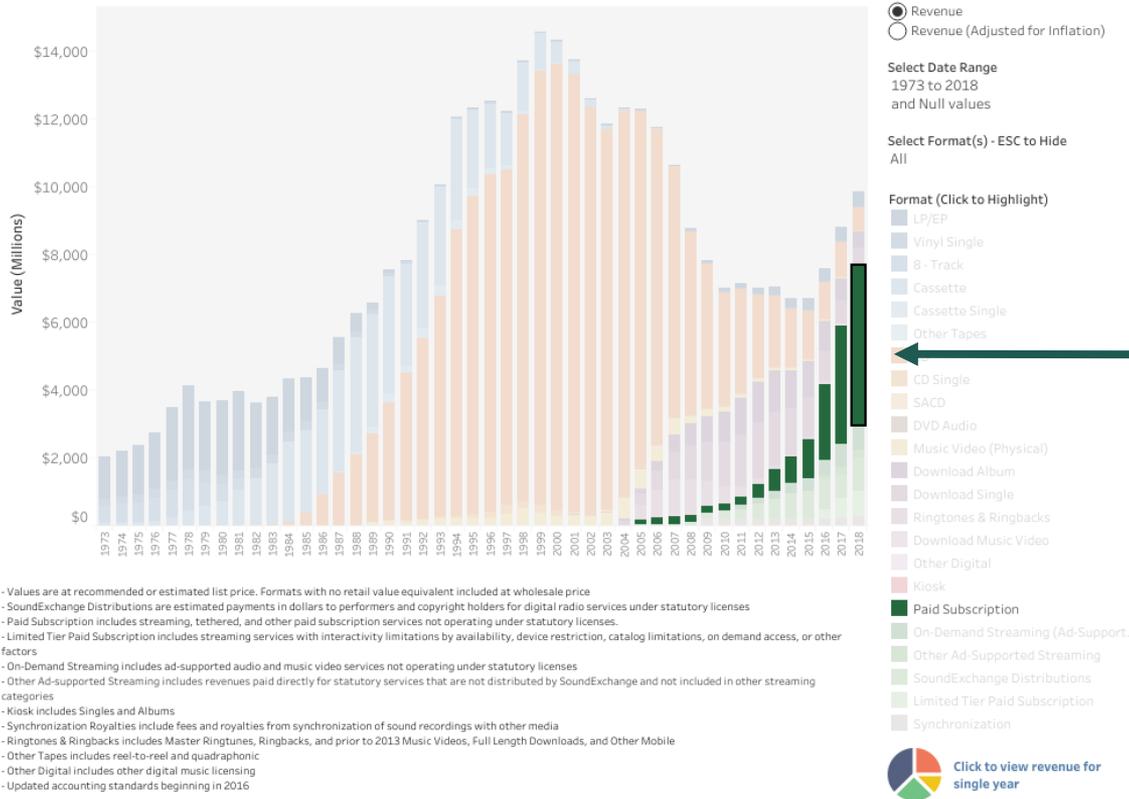
[Click to view sales volume for single year](#)

# ... and Streaming Has Taken Over

## U.S. Recorded Music Revenues by Format

1973 to 2018, Format(s): All

Source: RIAA



Source: RIAA. Permission to cite or copy these statistics is hereby granted, as long as proper attribution is given to the Recording Industry Association of America

**Revenue from streaming services has increased from \$643MM to \$4.7B in five years and now accounts for 47% of U.S. recorded music revenue**

- Values are at recommended or estimated list price. Formats with no retail value equivalent included at wholesale price
- SoundExchange Distributions are estimated payments in dollars to performers and copyright holders for digital radio services under statutory licenses
- Paid Subscription includes streaming, tethered, and other paid subscription services not operating under statutory licenses.
- Limited Tier Paid Subscription includes streaming services with interactivity limitations by availability, device restriction, catalog limitations, on demand access, or other factors
- On-Demand Streaming includes ad-supported audio and music video services not operating under statutory licenses
- Other Ad-supported Streaming includes revenues paid directly for statutory services that are not distributed by SoundExchange and not included in other streaming categories
- Kiosk includes Singles and Albums
- Synchronization Royalties include fees and royalties from synchronization of sound recordings with other media
- Ringtones & Ringbacks includes Master Ringtones, Ringbacks, and prior to 2013 Music Videos, Full Length Downloads, and Other Mobile
- Other Tapes includes reel-to-reel and quadrasonic
- Other Digital includes other digital music licensing
- Updated accounting standards beginning in 2016



# Artists Who Have Withheld Their Catalog

## Nearly Every Major Artist Has Returned

Artist	Added/Returned to Spotify	Monthly Listeners (MM)
Taylor Swift	2017	36.7
Coldplay	2015	27.7
The Beatles	2015	18.4
AC/DC	2015	15.9
Led Zeppelin	2013	12.4
Pink Floyd	2013	10.7
Prince	2017	7.2
The Black Keys	2016	7.2
Jason Aldean	2015	6.2
Neil Young	2016	4.7
Bob Seger	2017	3.8

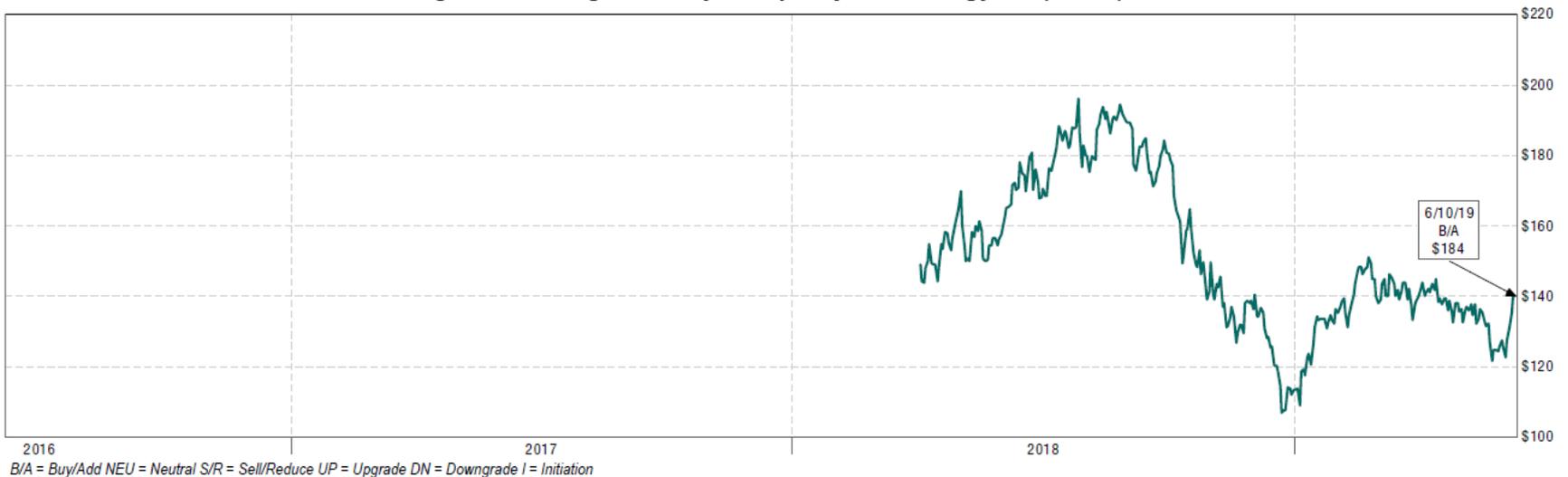
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I, Matt Griffith, CFA, attest that (i) all the views expressed in this research report accurately reflect my personal views about the common stock of the subject company, and (ii) no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in the report.

**WM Research Rating & Price Target History for Spotify Technology SA (SPOT) as of June 10, 2019**



# Required Disclosures

## RATINGS INFORMATION

**Buy/Add** - Security appears undervalued based on our current view of valuation measures, expectations, and its risk profile.

**Neutral** - Security appears fairly valued based on our current view of valuation measures, expectations, and its risk profile.

**Sell/Reduce** - Security appears over-valued based on our current view of valuation measures, expectations, and its risk profile.

Rating Distribution (as of 3/31/2019)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	WMR	Combined	IR	WMR	Combined
<b>BUY/ADD (Buy)</b>	59%	83%	60%	10%	4%	9%
<b>NEUTRAL (Hold)</b>	40%	17%	39%	5%	0%	5%
<b>SELL/REDUCE (Sell)</b>	1%	0%	1%	0%	0%	0%

*WMR denotes Wealth Management Research; IR denotes Institutional Research whose rating scale is Buy, Neutral, Underperform.*

*Investment Banking Distribution denotes companies from whom D.A. Davidson & Co. has received compensation in the last 12 months.*

Price targets are an evaluation of price potential over the next 12-18 months based upon assessment of future earnings and cash flow, comparable company valuations, growth prospects and other financial criteria. Certain risks may impede achievement of these price targets including, but not limited to, broader market and macroeconomic fluctuations and unforeseen changes in the subject company's fundamentals or business trends.

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## OTHER COMPANIES MENTIONED IN THIS REPORT

Company Name	Ticker	Rating	Price
Amazon.com Inc.	AMZN	Buy	\$1,804.03
Apple Inc.	AAPL	Buy	\$190.15
Google Inc.	GOOGL	Buy/Add	\$1,068.37
Tencent Music Entertainment Group	TME	NR	\$13.61

# Terms and Definitions

Term	Definition
€	Euro
ARPU	Average revenue per user
B	Billions
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation, and amortization
EV	Enterprise Value
FY	Fiscal Year
LTV	Lifetime value of a subscriber
MAU	Monthly active users
MM	Millions
P/E	Price-to-Earnings
P/FCF	Price-to-Free Cash Flow
P/S	Price-to-Sales
SAC	Subscriber acquisition cost
TTM	Trailing Twelve Month





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