Spotify Technology Sa Com

Recommendation: Long

Spotify is an under-appreciated music and media juggernaut and is the #2 (out of 200) ranked brand from our Brands Relevancy Scoring system

EXPECTED RETURN	TIMEFRAME	POSTED
37.6%	2 Years To 5 Years	2/25/2020

Author: Eric Clark

Posted While At: Accuvest Global Advisors

Disclaimer

SumZero is not a registered investment advisor or broker-dealer, and is not licensed nor qualified to provide investment advice. There is no requirement that any of our Information Providers be registered investment advisors or broker-dealers. Nothing published or made available by or through SumZero should be considered personalized investment advice, investment services or a solicitation to BUY, SELL, or HOLD any securities or other investments mentioned by SumZero or the Information Providers. Never invest based purely on our publication or information, which is provided on an "as is" basis without representations. Past performance is not indicative of future results. YOU SHOULD VERIFY ALL CLAIMS, DO YOUR OWN DUE DILIGENCE AND/OR SEEK YOUR OWN PROFESSIONAL ADVISOR AND CONSIDER THE INVESTMENT OBJECTIVES AND RISKS AND YOUR OWN NEEDS AND GOALS BEFORE INVESTING IN ANY SECURITIES MENTIONED. INVESTMENT DOES NOT GUARANTEE A POSITIVE RETURN AS STOCKS ARE SUBJECT TO MARKET RISKS, INCLUDING THE POTENTIAL LOSS OF PRINCIPAL. You further acknowledge that SumZero, the Information Providers or their respective affliates, employers, employees, officers, members, managers and directors, may or may not hold positions in one or more of the securities in the Information and may trade at any time, without notification to you, based on the information they are providing and will not necessarily disclose this information to subscribers, nor the time the positions the securities were acquired. You confirm that you have read and understand, and agree to, our full disclaimer and terms of use, a copy of which can be accessed by visiting sumzero.com and that neither SumZero nor any of its Information Providers is in any way responsible for any investment losses you may incur under any circumstances.

About Eric Clark

I've been in the financial services industry for 25 years and have spent time in virtually every part of the enterprise: Sales, Marketing, Portfolio Management, Product Development. I'm unique in the industry because I'm not a traditional thinker. I created a unique Index called the Alpha Brands Consumer Spending Index and manage equity portfolio's using the index of 200 leading brands as my investment universe. My mandate is to outperform the S&P 500 every year and to protect capital at all costs. To do that I monitor a proprietary Macro dashboard, significant style factor data, micro fundamentals from within my 200 index constituents, and market/brand technicals. I can prove significant alpha can be generated by being dedicated to the global consumer spending theme via the most relevant and recognizable brands as well as having a more flexible mandate that allows me to dial up or down risk exposures according to the cycle and current market environment.

Spotify Technology Sa Com

Asset Class: **Equity** Symbol: **SPOT:US** Updated: **2/25/2020** Posted: **2/25/2020**

BY:
Eric Clark

CURRENTLY AT
Accuvest Global Advisors

COMMUNITY RATING: *4 votes needed* PERCENTILE: **N/A**

Return Performance

RETURN TO DATE:	*Pending...*
EXPECTED RETURN:	37.6%
IRR:	N/A
RETURN VS. BENCHMARK: *(SPDR EURO STOXX 50 ETF)*	N/A

Spotify is an under-appreciated music and media juggernaut and is the #2 (out of 200) ranked brand from our Brands Relevancy Scoring system

Pricing Details — LONG

RECENT PRICE:	145.33 USD *2/24/20 at 11:59PM*
TARGET PRICE:	200.00 USD
INITIAL PRICE:	*Pending...*
CLOSING PRICE:	N/A

ASSET CLASS:	SITUATION:	TARGET ALLOCATION:	CATALYSTS:	TIMEFRAME:
Equity	GARP	5% - 10%		2-5 Years

Fundamentals

CURRENCY	United States Dollar
52 WK. RANGE	140.00 - 181.80 USD
MARKET CAP	26.8B USD
EV	25.51 Billion
TOTAL CASH	1.97 Billion
TOTAL DEBT	698 Million
BOOK VALUE PER SHARE	12.40
THREE MO. AVG. DAILY VOLUME (USD)	181,678,000
SELLSIDE CONSENSUS	1.50

Mutiples/Ratios

LTM P/E	-127.48
FORWARD P/E	-104.55
EV/EBITDA	1214.95
EV FCF	53.15
EV SALES	3.37
PRICE BOOK	11.72
FCF YIELD	0.02
DEBT BOOK	0.31
DIV YIELD	0.00

Additional Data

SECTOR	Communications
INDUSTRY	Media
COUNTRY	Luxembourg
REGION	Western Europe

Thesis

Disclaimer: *The author of this idea and the author's fund had a position in this security at the time of posting and may trade in and out of this position without informing the SumZero community.*

MEGA BRANDS
HSUTX

Date: 2/24/2020

Written by: Eric Clark, Portfolio Manager, Mega Brands Equity – Accuvest Global Advisors

Long: Spotify: SPOT

First Target: $200

Ultimate Target: $50b market cap or $267

Commentary:

If you have read any of my reports in the past you will know I am focused on the most relevant brands serving global consumers. I focus on brand relevancy while understanding the current and future trends that will drive traditional financial metrics. The music/podcast/video theme is a very important category for consumers and offers significant long term opportunities for investors. I have stated my opinion many times but will re-state here: most analysts do not understand or even model for the true value of “the brand”. It’s an intangible asset and typically not found in the places that most equity analysts spend their time on. The financial data inside each company is a very one dimensional viewpoint and backward looking as well. Guessing where the numbers will be has never offered me an edge to making money but I do maintain a full set of metrics across all important parts of the balance sheet and income statement. As I have written before, me and my team have a quant bias for the data, a technical focus for entries and exits and a quant/qual focus for the brand relevancy scoring system. This is not a commentary on the analyst community, just a differing opinion and investment process. Now back to Spotify.

Spotify is the dominant streaming music platform for music around the world. They own the most sophisticated algorithms that help drive increased user engagement. The user interface is the most simple and easy to use for consumers. But music is just the entrée for Spotify. The issues surrounding working with the music labels are well documented. As Spotify's reach continues to expand, so too will their leverage over the labels. That will ultimately drive better economics for the music business but the real opportunity in my opinion is the audiocasting, aka podcasts. Add to that the optionality of taking newly owned content and offering a streaming video subscription that's proprietary to Spotify or building partnerships with media giants like Netflix or Disney and you have many ways to win in a stock that's been left for dead among most investors. Since the direct IPO, Spotify has largely been an underperformer as they build a more diverse revenue stream

When a company has significantly high "brand value" and the stock has been a serial laggard, the potential for strong forward gains tends to be high. My last report that met this criteria was RH, a stock that was under-appreciated, cheap and growing well and has since gone much higher and outperformed the S&P 500 significantly. I still think RH double or triples over time as they begin expanding and building their galleries in every major international city. Berkshire Hathaway has recently increased their ownership of the stock as well based on 13-F's I have read. My favorite set-up is a lagging stock, high short interest with super high brand value and brand love.

Company Description:

Spotify is the largest and most important pure play streaming music brand around the globe. The company is at the center of a few very important mega-themes we focus on: Millennials & Gen-Z transforming the economy, digital & streaming content, subscription-based models, asset light businesses, and the experience economy. Spotify is a Mega-Brand for sure. What's a Mega-Brand? The brands in my 200 leading brands index that can be considered a Mega-Brand must meet these criteria:

1. High scores across my 40+ factor brand relevancy scoring system (quant/qual): Yes
   a. Spotify is #2 of 200, Tesla is #1 (I recently sold Tesla as the parabolic stock now discounts easily a decade worth of wonderful results).
2. High brand love and customer obsession – Yes – if you are a music junkie, Spotify is the only real game in town.
3. Culture of innovation & obsessed, forward thinking management – Yes, plus we get a founder in Daniel Ek who is young, committed and holds about 18% of the stock last I checked.
4. Category leader with strong and recurring revenue opportunities – Yes, Spotify is the leader in MAU's and is building a recurring revenue and cash flow machine.
5. Serving a global audience - Yes, Spotify has loyalists in 79 countries thus far.
6. Appeals to multiple demographic groups – Yes, Spotify has brand love from Gen-Z to Baby Boomers but certainly skews from the 55 and younger demographic, which is where there is a significant number of people. Gen-Z & Millennials are roughly half of the current U.S. population and there are more Millennials in Asia than the entire population in the United States. This theme and demographic combo offers significant opportunities for the brands that resonate most.

Spotify's Business:

- Financials
    - Total revenue for the recent quarter (Q4 2019) was $1.855 billion +24% YOY.
    - Premium revenue was $1.638 billion up 24% YOY – paying customers drive this platform. That says a lot about the brand loyalty & brand power.
    - Ad-supported revenue was $217m up 23% YOY.
    - Premium ARPU was $4.65, down 5% YOY due to extension of promotions & FX.
    - Gross margins: + 25.6% in Q4, toward the high end of guidance.
    - Royalty costs were in-line with expectations.
    - Premium gross margins: +26.9% up from 26.5% in Q3 but down 40bps YOY.
    - Ad-supported gross margins: +15.4% down 670 bps YOY.
    - Operating expenses of $551m increased 80% YOY as SPOT is subject to social taxes in several countries it operates in.
    - Generated $203m net cash flows from operations
    - Generated $169m in free cash flow in the quarter.
    - Maintain positive working capital and expect this dynamic to continue for FY 2020.
    - Expecting FCF to be negative in Q1 2020 from payments of licensors & timing.

- Expect to deliver positive free cash flow for 2020.
- Ended Q4 2019 with $1.8B in cash and cash equivalents.
- I think it's important to understand the company is sacrificing margins near term to build bigger capabilities long term that will drive higher margins, revenue and cash flow. This is a bet on their ability to execute and on their view of strong and continued adoption of podcast content but it is a bet I am happy to make.
- Guidance:

Q1 2020 Guidance:

- Total MAUs: 279-289 million
- Total Premium Subscribers: 126-131 million
- Total Revenue: €1.71-€1.91 billion
- Gross Margin: 23.5-25.5%
- Operating Profit/Loss: €(65)-€(115) million

Full Year 2020 Guidance:

- Total MAUs: 328-348 million
- Total Premium Subscribers: 143-153 million
- Total Revenue: €8.08-€8.48 billion
- Gross Margin: 23.2-25.2%
- Operating Profit/Loss: €(150)-€(250) million

- M&A showing us what they intend to build – An extensive audio/video flywheel with an end-to-end solution for all parts of the process that include: content, distribution, monetization tools, technology, staffing, and via all important mediums of consumption. Here's a list of acquisitions from the most recent to the oldest.
  - The Ringer by Bill Simmons – acquired 2/5/2020.
    - Pop culture, technology and sports talk. Let's call this ESPN2.0 and a very popular, important category to draw more listeners into the platform.
  - Sound Better – acquired 9/12/19.

    - A marketplace for music production for sound engineers, singers, and studios. Connects musicians with the professionals they need to hire to produce content.

- Parcast – acquired 3/26/19.

    - A popular network for scripted story-telling content.

    - Acquiring the content and loyalists allows them to potentially create/license streaming video with the most popular stories.

    - Stories: Serial Killers, Summer of '69,Gone, Conspiracy Theories, Assassinations, Cults, Female Criminals, Haunted Places, Historical Figures, Hostage, Kinpins to name just a few.

- Gimlet Media – acquired 2/6/19.

    - A podcast content network with an estimated 7 million downloads per month with users across 190 countries. Estimated purchase price: $230m. Gimlet started with narrative reporting but expanded into radio dramas, childrens programming and talk radio. Gimlet owns a significant amount of content across genres and offers additional potential video streaming opportunities.

    - Popular shows: StartUp, The Habitat, The Nod, HeavyWeight, Science Vs, Reply All to name a few.

- Anchor – acquired 2/16/19.

    - Offers creators a "podcast in a box" solution that makes it easy to create and distribute podcasts across all the important distribution platforms. Is now offering creators the ability to generate ad revenue embedded inside each podcast.

- LoudR – acquired 4/12/18.

    - Builds products and services to make it easier for content creators, aggregators, and digital music services to identify, track and pay music publishers. LoudR makes it easy to secure mechanical rights clearance for song usage at scale.

- SoundTrap – acquired 11/17/17.
    - Operates a user friendly online music recording & collaboration studio across major platforms. Very popular in schools for music education.
- Niland – acquired 5/17/17.
    - Music start-up that enables companies to reach new levels of customer engagement. Enabled by AI algorithms and is a key reason Spotify's AI engine drives customer engagement and music/podcast exploration.
- Mediachain – acquired 4/26/17.
    - Protocol for registering, identifying and tracking data. MetaData focused firm. Allows users to maintain control over their data.
- MightyTV – acquired 3/27/17.
    - TV streaming video service that's AI driven using preferences and the opinions of ones peer group and friends.
    - This is my favorite acquisition and is the Disney BamTech for Spotify.

The customer engagement flywheel Spotify is building is absolutely not fully known or appreciated by investors. They are building and buying all the pieces of the puzzle to build a music, podcast, video streaming network with global reach and leveraging their high brand love around the world. Owning the content and production talent is essential to monetizing these assets across different verticals. How long before we hear about their intent to take popular podcast stories and creating feature films or distributing them via a popular streaming video platform? So many ways to win for Spotify. The music revenue could become the cash flow machine that pays for all their other aspirations making this an underappreciated revenue and cash flow juggernaut over time. Let's look at the business segments:

- Streaming music
    - SPOT currently has total MAU's of 271 million +30% YOY
    - 3 consecutive quarters of accelerating MAU growth and a record year of net subscriber additions.
    - Strong MAU growth has historically led to stronger forward premium subscriber growth.
    - Premium subs grew 11million to 124 million & churn improved.
    - Q4 2019 was the highest net add quarter the company has ever experienced and the fastest they have ever added 10 million subscribers.
    - During the quarter, SPOT expanded their "3 months on us" campaign to new Family Plan subscribers.
    - The Google Home partnership (new & existing subscribers can get a Home Mini for free) continues to perform above their incremental new subscriber expectations so we should expect them to continue with this program.
    - Spotify continues to spend on marketing with various campaigns – free trial promotions.
    - Volatility surrounding the timing and details around label negotiations will continue but the company is confident they have leverage given the size of the platform.
    - Given favorable demographics, strong demand in the music and audiocast categories and being the go-to platform for loyalists, I believe Spotify should see 500m MAU's over the next 5 years.

That offers significant stability, revenue opportunities and free cash flow generation.

- Their overall goal is a noble one – allow +1million artists to live off their work using Spotify as the centerpiece.

- Audiocasting – Podcasts
    - This is an enormous opportunity the market is not fully considering because they require comps and there are no comps.
    - Podcasting has become extremely popular but monetizing podcasts is still early days. Modeling the opportunity for revenues from this segment is akin to guessing so I choose not to guess. I am confident that Spotify will continue to improve the monetization model as the early leader and we know those margins are much better than the music margins. I am also confident that in 5 years, the podcast market will offer an even better revenue and cash flow opportunity than music currently does if current trends persist and/or accelerate.
    - Podcast hours streamed continues to grow exponentially (+200% Y/Y) off a low overall base.
    - Podcast usage continues to drive better user engagement and lower overall churn.
    - Spotify is in heavy investment mode for this business line and continues to build a significant and valuable flywheel for the benefit of consumers, creators and artists. That should continue to foster loyalty and smoothing of revenues and cash flows.
    - Investments in podcasts have been having a positive impact on the conversion of free, ad-supported users going to paying, premium subscribers.
    - Management believes their continued spending on podcast technology and content acquisition should be viewed as an indication of their confidence in the strategy continuing to add to future opportunities. I know Wall Street doesn't like "investment years" ex-Amazon but management should be given the benefit of the doubt to turn investment dollars into tangible revenue opportunities.

- >16% of total MAU's now engage with podcast content and consumption hours in Q4 2019 have grown 200% YOY.

- SPOT has >700,000 podcast titles on the platform.

- Management continues to see the benefits to retention on an order of magnitude of several hundred basis points – a material change in the retention curve.

- There is still plenty of work to be done to further enhance loyalty, increase retention, and drive revenue and cash flow growth.

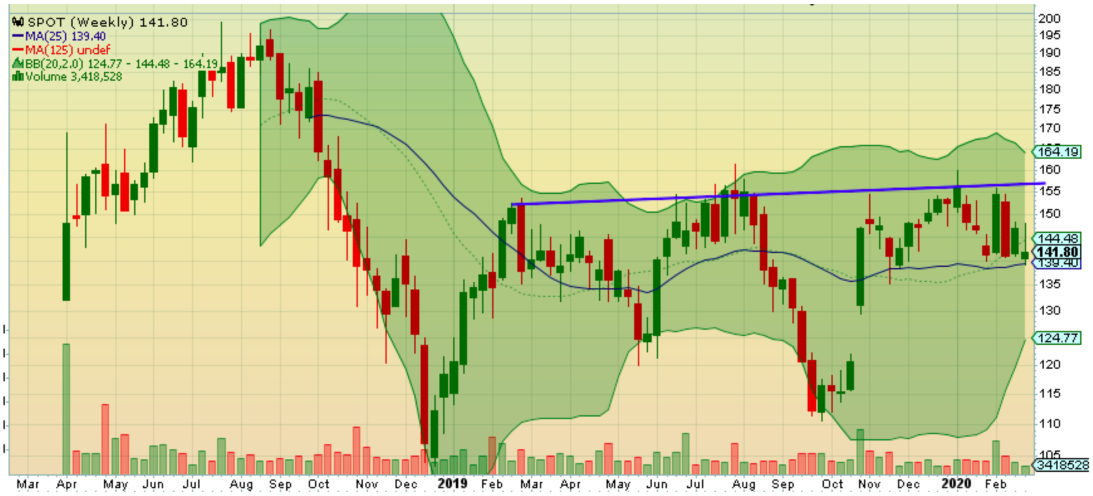
- Each quarter offers more clarity on the two-sided marketplace – listeners and tools for creators of music and podcasts. The more success they have here, the wider the economic moat and network effect becomes. For 2020, management expects the growth in Marketplace contribution will be in excess of 50% of total revenues.

- Spotify has acquired a few key properties to expand its reach in podcasts. The latest was The Ringer, a pop culture media firm that's very popular and what I call ESPN2.0.

- Potential of Streaming Video

Spotify has been very active in M&A over the last 18 months as I have shown above. They have acquired the pieces that are required to offer an end to end music, podcast, and ultimately a streaming video service to global consumers. I have no opinion on whether this will be a build vs license approach but all the pieces are being put in place. Between the strong and recurring revenue from their traditional music business, the ad-revenue from freemium music and increasingly the podcast business plus the optionality inside the content they own for building or licensing a streaming video service, the current market cap of $26.3 billion on revenue of about $7.5 billion seems quite low given the potential for revenue and cash flows to slingshot higher once the entire flywheel gets in motion. The underperformance of the stock since their direct listing coupled with the under-appreciated nature of the business is completely disconnected with the long term opportunity Spotify is addressing. In a world where very few companies get a "pass" for investment years, Spotify has proven the spend they do adds meaningful value to the enterprise value of the company.

From a technical perspective, SPOT is a ball under water, just building pressure under strong resistance. I recommend allocators start to accumulate the stock while it's under this resistance at $157.5 for the inevitable break of the ceiling on its way to $200 as a next stop. There is a gap that can be filled around $125 so that is a consideration as you consider an allocation. I will happily add more shares at the level if the market continues to sell-off. In the recent sell-off on the Corona Virus, SPOT has held up rather well versus other tech stocks. It's my belief that a leading company with the most relevant brand delivering a stellar product and customer experience with global opportunities and demographic diversity is a strong addition to a portfolio. The fact that few appreciate and understand what Spotify will become in 5 years makes this a particularly attractive entry at current levels. In my opinion, based on all the variable above, Spotify will one day be a $50b company with the possibility of being a $100B company over a longer period of time. Spotify would make a solid acquisition target for one of the large media or technology platforms.



Risks:

- Future negotiations with the music labels fail and hurt Spotify's ability to offer part of their current library. Given their MAU's and brand love, that seems a low risk currently. Lower royalty payments will cap margins.

- Labels form a collective and decide to build their own streaming music offering to compete and capture more of the revenue in the category. That seems even less likely given the capital and IP needed to build a business at scale. Plus building a brand is very tough and very expensive.

- Podcast business does not continue to with its momentum making the acquisitions worth less than the future opportunities currently appear to be.

- Competition – Amazon, Google, Apple music begin to aggressively market and take subscribers from Spotify.

- Increased regulations of ad-supported businesses could hold back monetization efforts.

- Revenues stall at current levels making the stock look more expensive without growth to justify the valuation.

- Ad spending dries up across verticals and the industry.

- Margin leverage fails to meet the projections based on new subscribers.

Idea Updates

The author has not yet posted any updates for this idea.

Comments

There are no comments yet on this idea.

Visit **https://sumzero.com/pro/research/ideas/18376** and start the discussion.

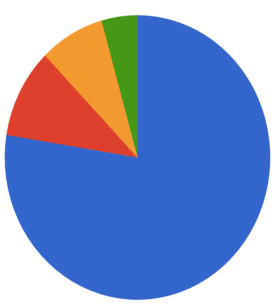
About SumZero

SumZero is the world's largest community of investment professionals working at hedge funds, mutual funds, and private equity funds. With nearly 15,000 pre-screened professionals collaborating on a fully-transparent platform, SumZero fosters the sharing of many thousands of proprietary investment reports every year and offers several ancillary services in support of that effort. These free services include capital introduction services, buyside career placement services, media placement, and more. SumZero's membership base is represented by analysts and PMs at nearly all of the world's largest and most prominent investment funds.

10,000+

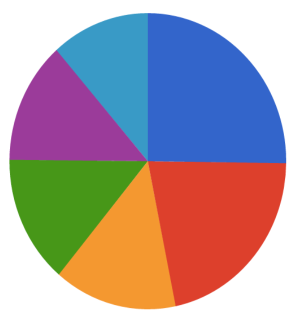
Ideas Published on SumZero

REGION



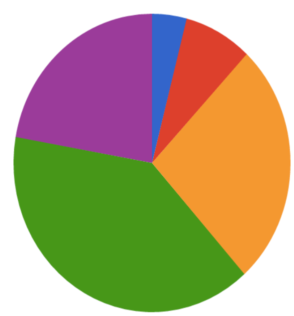
- **North America -** 77.5%
- **Western Europe -** 10.2%
- **East and South Asia -** 7.9%
- **Other -** 4.4%

MARKET CAP

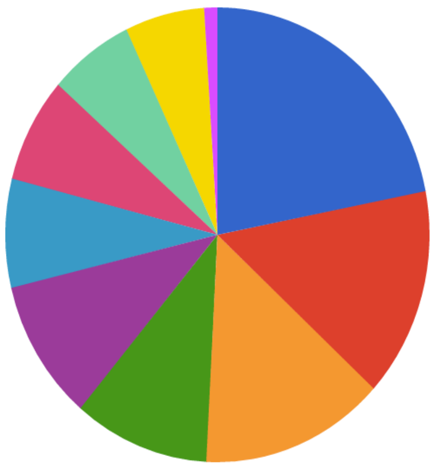


- **Small Cap -** 25.2%
- **Mid Cap -** 21.6%
- **Mega Cap -** 14.4%
- **Micro Cap -** 14.0%
- **Large Cap -** 13.4%
- **Nano Cap -** 11.5%

TIMEFRAME



- **Less than 3 months -** 4.0%
- **3-6 months -** 8.0%
- **6 mo. - 1 Year -** 26.4%
- **1-2 Years -** 39.4%
- **2-5 Years -** 22.2%



IDEA BREAKDOWN BY SECTOR

- **Consumer Discretionary -** 21.9%
- **Financials -** 14.9%
- **Technology -** 14.0%
- **Industrials -** 10.3%
- **Communications -** 10.1%
- **Energy -** 7.7%
- **Materials -** 7.5%
- **Consumer Staples -** 6.5%
- **Health Care -** 6.1%
- **Utilities -** 1.0%

IDEA BREAKDOWN BY DIRECTION

LONG	SHORT
85%	15%

- **21%** of all ideas on SumZero contain at least one catalyst type
- A full write-up on SumZero contains an average of **2,376** words
- **8,000+** Companies Covered

Join SumZero

Visit https://sumzero.com to start your free trial.