



Holland Views: Spotify – Price \$142 - M.Cap \$26bn

Spot Prize

A toll road is perhaps one of the best original cash collecting business models. As admirers of the modern versions of it including the likes of Mastercard and Moody's, we are always on the lookout for a new one. Additionally, we have spent a lot of time recently studying disruptive businesses and the managers that established them. Spotify is a company we think potentially falls into both of these categories. Hard core value investors will see very low margins and high PE multiples. We see these too, but we also see many other business and entrepreneurial drivers that we seek – **Buy Spotify**.

Disruptors – Common Traits

During 2019 we read three biographies that detailed the business lives of three unconnected but highly successful business leaders¹. These contained fascinating stories of how each individual found their way to business excellence. However, what really resonated with us was a number of consistent traits that ran through all three even though they were decades and oceans apart. Having studied business books like 'Outsiders' and 'Good to Great' we know well the *theory* of what type of businesses excel, but there is nothing like real-life stories to make these traits really come to life.

Each of these books² offers a first-hand account of what it takes to be a disrupter. Their study covers diverse markets such as low-cost airlines, alternative telecom carriers and wealth management. Each company leader possessed the owner manager/entrepreneurial/allocation skills we seek, but importantly also additional common traits. All these disrupters:

- Challenged the status quo within their industry
- Offered the customer a step change in value for money
- As a result, the product/service/company was typically
 - loved by the customer...
 - ...but hated, discredited (even ridiculed) by the incumbent industry players

We thought these were interesting commonalities and ones that arguably if we had known to look for them maybe we could have identified these companies as winners earlier in their lives. Reflecting on how powerful these disrupter businesses became from very small starting positions had us thinking about what other sectors are ripe for such disruption and who is doing the disrupting?

Thinking on this, not just using our analytical hats, but those of consumers in a modern society has thrown up a sector and a company we know very well indeed from a user's perspective – the music/audio industry and specifically **Spotify**. We have spent a great deal of time in recent weeks studying this company and we very much like what we have found.

¹ Charles Schwab, Michael O'Leary and Howard Jonas

² Invested, Michael O'Leary (Turbulent times for the man that made Ryanair), On A Roll

Enter Spotify

In this note we address:

1. The business model employed by Spotify and how it and its founder Daniel Ek exhibits many of the disrupter (and ‘Outsider’) traits we look for
2. The competitive landscape, noting the biggest challenge coming from Apple and Amazon no less
3. The end game: The opportunity to be the primary toll road for global audio distribution

A land grab and the big prize: A global toll road on audio

“I don’t think the market necessarily is purchased music. I think the market is much larger than that. I think it’s audio. Two billion people listen to radio. Most of that today isn’t monetized very efficiently. It doesn’t get back to the artists in any real form. And it’s kind of unclear who gets what. If you think about commercial radio, today, conservatively, that’s a \$50 billion industry globally. The U.S. industry is \$17 billion. What do people listen to? Primarily music. The market is much bigger than most people think.” – Daniel Ek- Spotify CEO and Founder

Spotify, we think is an interesting disrupter business. We assess it as such for the simple reason that very quickly we were able to assert that it possesses nearly all of the traits we outlined above that disrupters have in common.

- That is to say, both it and the pirate music streamers that went before it radically challenged the industry status quo
- As a result, they were hugely unpopular/discredited within the wider music industry whilst being hugely popular with the end user
- Not only have they offered phenomenal value for music lovers globally – all the music you can eat on multiple devices for c.\$10 a month or alternatively, free! They have also arguably democratised both music creation and its consumption
 - The world’s music catalogue is now available globally (for free) to any one of the c.2-3bn people who have a smart phone
 - Music can also be directly uploaded by thousands of artists for almost no cost

In addition to its 113m paying subscribers, another 141 million Spotify subscribers get music for free via an ad-supported subscription platform (they are the only provider that offers this). The result is a super simple to sign up product that offers free unlimited music on a great interface to anyone in the world with a device and email address. It can be personalised; it is free and it is forever. No credit card is asked for and there is no compulsory Google-like identify grab. Every few songs you will hear a 10 second advert, but hey what do you expect for free?! Spotify’s data shows that 60% of its new paying subs come from the ‘freemium’ users as they call them. As we note later such a conversion process makes its runway towards an even bigger and more profitable company easier to foresee.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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