

# HollAnd

Advisors

Holland Views – Spotify – Price: \$336; MCap: \$64bn

## Focus and Flywheels

In our first in-depth look at Spotify early last year (Holland Views, Spotify - Spot Prize, \$142 January 2020) we suggested that Spotify was becoming a ‘global toll road on audio streaming’. Twelve months later, this assertion is looking a lot less outlandish. Whether you see this business as a toll road or a classic tech platform is not the point, the point here is the scale of the opportunity that is unfolding in front of Daniel Ek’s Spotify is truly massive. As the pure play, early-mover in audio streaming we think this market is Spotify’s to lose.

[Sometimes, just sometimes, our timing is good!!](#)



Source: Bloomberg

On Monday last, Ek and his team laid out an intriguing case for how Spotify can dominate the global audio market (watch ‘Stream-On’ here<sup>1</sup> and look at our marked-up transcript attached). We encourage you to keep abreast of what this great visionary and his company are undertaking. The scale of opportunity they lay out is enormous, both in the 5-7x increase in size of their current business (streaming) and in the new revenue streams that are arising from deeper artist relationships. Some might dismiss such targets as hyperbolic, par for the course with tech companies etc. But the important point to ‘get’ here is the value-add that Spotify is offering to artists, labels and consumers – the shared features (and economics!) of scale that we love. Indeed, on page one no less of the Daniel Ek’s speech readers will find the phrase “*interlocking flywheels*”.

<sup>1</sup> <https://youtu.be/Vvo-2MrSgFE>

As an aside, we might remind you that the pending IPO of Universal Music by Vivendi and Vincent Bollore could bring renewed investor attention to this sector and Spotify's increasing role in the value chain.

#### [If its growth you want – here is a market for you](#)

- Post announcing 85 new markets this week, Spotify will soon be present in c178 global markets. The company's mission, to remind you, is 1m artists and 1bn users. These are clearly extremely big numbers.
- This week Ek cited a 2030 total addressable market (TAM) of \$130bn (vs. current Spot revenue of \$8bn). Specifically, Ek thinks Spotify can grow 5-7x over the next decade! Taken at face value, this suggests Spot could generate \$50bn in annual revenues (vs. today's market cap of \$64bn).
- In terms of margins (which have been elusive thus far we concede), the CFO has now placed a marker down at the EIBIT level: "*our goal is 10% plus*". Clearly this depends on growth but also on the mix of advertising and own-content (podcasting). Of the latter, the opportunity to eat into radio advertising's c.\$50bn market sounds very plausible, as we observed last year.
- Realising that revenue goal will of course be very dependent on Spotify's four strategic pillars ('Create. Grow, Engage and Monetise') – especially the latter, *monetise*. To that end many have noted the company's efforts to add new features and pricing levels (e.g. HiFi). However, for us, it is the deep-seated efforts by Spotify to add value to all three sides of the marketplace that is exciting: 1. **Artists** (discovery/promotion), 2. **Labels** (distribution and cost reduction) and 3. **Users** (discovery, price and experiential joy!).

#### [Markers + The futility of short-term valuation](#)

We think this week's investor day was impressive as it showed the speed at which this company is continuing to evolve. As it does so it serves its two main stakeholders better each year, i.e. **Users and Artists**. As the relationship with these groups deepen the moat around this business grows. As a result, the network effects are increased and markets for new services are created (Enhanced Albums, Touring, Clips etc). In our piece last year we spoke of the focus Spotify brought to the music and audio space and how distinct that was from Apple's approach. That continues to be the case. A 2009 letter from Napster founder and Zuckerberg right hand man Sean Parker we thought spoke strongly to that point.

<https://genius.com/Sean-parker-sean-parker-s-email-to-spotifys-daniel-ek-annotated>

Valuing such businesses is never easy. We are pleased that the 10-15% EBIT margin guesstimate we made last year has been confirmed by the company as its longer-term target. Last year we also mooted the thought that were a per year profit value of \$10 per paid sub and \$3 per advertising sub to accrue to this business then a few years out this could equate to a PBT of c.\$3.7bn. (This used 250m paying subs and 300m advertising subs). When we did this calculation the market cap of the company was \$26bn, today it is \$64bn. None of these calculations are easy, particularly against the scale of the opportunity in front of the group, nor vs. the context of the recent doubling of the share price.

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

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