



Rating
Hold

North America
United States

TMT
Internet

Company
Spotify

Reuters SPOT.N Bloomberg SPOT US Exchange NYS Ticker SPOT

Date
31 October 2018

Forecast Change

| | |
|----------------------------|-----------------|
| Price at 30 Oct 2018 (USD) | 141.68 |
| Price target | 154.00 |
| 52-week range | 196.28 - 139.11 |

3Q Preview

The Key Takeaways

We expect the company to report a solid 3Q, continuing the momentum from recent quarters, and supported by entry into new markets, new distribution/bundling partnerships (e.g. Samsung and Showtime/Hulu), and extended free promotional offers. Our estimates for the quarter are generally in line with Street. Nevertheless, in the absence of tangible valuation support, SPOT shares have trended down recently with the overall correction in the tech space, and largely tracking Netflix share prices during the period. Despite lower valuations, near term the stock trades with higher beta Internet names with less upside scope to estimates, in our view, and heading into contract renegotiations with major labels next year we are concerned headline risk warrants near term caution. Our TP goes to \$154 from \$183 to reflect lower market multiples, primarily using Netflix EV/gross profit as a comp. We continue to think looking at Spotify on EV/revenue makes less sense given it's considerably lower gross margins than peers, even in it's long-term margin forecasts which look ambitious to us.

Street is modeling a tight range on subs for 3Q

We are in line with the street for 3Q premium subs at 87M (consensus 87m) and slightly above on ad-supported MAU's of 109M (consensus 107M) which trickles down to being a hair below consensus on revenue of growth of 28.2% (consensus of 29.4%). We note that the consensus range for premium subs is very tight according to Factset while the consensus spread for Ad-supported MAU's is slightly wider varying from 104M to 110M. We see GM's of 25% which is a hair above the street (consensus of 24.8%). Looking towards 4Q we are in line with the street for premium subscribers of 96M (consensus 96M), slightly above on Ad-supported MAU's of 112M (consensus of 111M), and are on the high end of the guide and remain above consensus for revenue growth of 32.4% (consensus of 29.6%) and in line for GM's of 25.84% (consensus of 25.88%). We think the margin outlook for GMs will be important, particularly as we get closer to 2019 and further from the last round of renegotiations.

Music Modernization Act

On October 11, 2018 the Music Modernization Act was signed into law and should provide a tailwind for Spotify in the future as this new formalized body, run by publishers, should alleviate cost, time, and effort on Spotify's part. By modernizing the process, putting unclaimed royalties with content creators (not Spotify), and creating a comprehensive database this should alleviate double payments, lack of payments, and reduce reserves necessary for this type of payment cluster. Now that the Music Modernization Act was signed into law, we will be looking to hear

Valuation & Risks

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Key changes

| | | | |
|----------------|--------------------|---|--------|
| TP | 189.00 to 154.00 | ↓ | -18.5% |
| EPS (EUR) | - | ↓ | 0.0% |
| Revenue (EURm) | 5,256.8 to 5,256.6 | ↓ | -0.0% |

Source: Deutsche Bank

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more with regards to the impact of having a central clearing house for royalty payments to rights holders. Specifically, we have heard that streaming platforms are paying copyright royalties in excess of what the actual royalty payments are given that current royalty payments are collected through agencies that are not operating with complete data. While CFO Barry McCarthy stated that he expects "no specific impacts on gross margin," he did also call out that it should help "dramatically in the remittance of license fee payments" and that it will enable them to "know who to pay, full stop." Ultimately, we believe that this could be a slight tailwind to gross margins assuming that the current collection of copyright royalties were ~8% in excess of the actual amount and copyright royalties are a mid-teens percentage of music revenue.

Competitive environment update

We highlight three relevant articles to the competitive landscape. The first article, published in The Verge ([Link](#)) describes Spotify's recent partnership with Samsung. One of the effective acquisition strategies for top of funnel MAUs in music streaming in the past and lately has been through telco-bundling. In early August, Samsung announced a partnership with Spotify that will span across all of Samsung's devices (phones, TVs, smart speakers, etc.) and the Spotify sign-in/up process will be a part of all new device setup processes. In our mind, this should be a be an effective way to acquire new subs in regions ex-US and we hope to continue to learn more about the impact of the partnership. The second article from Bloomberg ([Link](#)) shows demonstrates Amazon's aggressive attitude towards music streaming. While we have always identified Amazon as a major threat amongst the Western competitors, we think its decision to launch a national TV campaign for its music streaming service shows that they are serious about the offering and will help them further improve retention for their Prime program. We view this as a marginal negative for Spotify as it further supports the fact that the "tech giants" want to be aggressive in the music streaming market. The final piece we want to talk about comes from Spotify ([Link](#)) communicating that they added Showtime to their current \$5 Hulu / Spotify bundle for students. The company has already highlighted that the Hulu bundle has been a great acquisition funnel for young students who should have a high LTV so further enhancing the offering with Showtime should be an incremental positive to acquiring valuable subs.

What we hope to learn on the call

On the call, we look for more color around the company's geographical expansion initiatives in to India, Russia, Africa, and the Middle East ([Link](#)). Specifically in these new potential markets, we would like to learn about the competitive landscape, current label deals in place in these markets, and propensity for consumers to spend on music streaming and a better understand of how the company is approaching business development in these markets given some feedback we have heard in the industry. In addition to geographical expansion, we look to continue to learn more about how the company is signing musicians directly / the impact to label relationships and any new creative advertising opportunities the company is thinking of launching. Finally, we look for an update on how the 60-day free trial has been trending.

Middle East Market Launch Ahead?

Press reports point to the Middle East as an upcoming new market for Spotify that could help provide runway for subscriber growth in 2019. The region's 335M population, or ~170M excluding countries like Syria, Iran, and Iraq, have paid music subscribers of ~1M in 2017, per MiDIA data, or less than 1% of the addressable Middle East market. This suggests a lot of potential growth ahead.

Price/price relative



| Performance (%) | 1m | 3m | 12m |
|-----------------|-------|-------|-----|
| Absolute | -21.7 | -19.9 | - |
| S&P 500 INDEX | -7.9 | -4.3 | 4.3 |

Source: Deutsche Bank

Key indicators (FY1)

| | |
|------------------------|--------|
| ROE (%) | -228.2 |
| ROA (%) | -39.3 |
| Net debt/equity (%) | -99.1 |
| Book value/share (EUR) | 5.13 |
| Price/book (x) | 23.6 |
| Net interest cover (x) | - |
| EBIT margin (%) | -5.2 |

Source: Deutsche Bank

Stock & option liquidity data

| | |
|-------------------------------------|----------|
| Market Cap (USDm) | 25,162.4 |
| Shares outstanding (m) | 177.6 |
| Free float (%) | 100 |
| Volume (30 Oct 2018) | 623,470 |
| Option volume (und. shrs., 1M avg.) | - |

Source: Deutsche Bank

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The large local player, Anghami has a solid market presence primarily through innovative offerings (pay-to-play tiers) and bundling with the leading regional telcos. In late 2017, Anghami had over 50M free streaming users (~66% y/y growth up from 30M in early 2017) compared to YouTube, Deezer, and Apple Music who all have a small subscriber base in the region. The market opportunity here looks interesting but the regional affinity for Anghami may post challenges for Spotify.

Valuation/Risks

Our \$154 price target (from \$189) is based on a combination of EV/revenue multiple of 3x (from 4x previously), an EV/gross profit multiple of 12.5x (from 16x previously) and a DCF analysis with a terminal multiple of 20x FCF (unchanged). We reduce these multiples to reflect peer group multiple contraction and continue to use a 25% discount to Netflix on EV/gross profit. Upside risks include faster sub growth/better margins. Downside risks include increasing competition, lower-than-expected sub growth and supply concentration.

| Forecasts and ratios | | | |
|----------------------|---------|---------|---------|
| Year End Dec 31 | 2017A | 2018E | 2019E |
| 1Q EPS | -1.15 | -1.01A | -0.77 |
| 2Q EPS | -1.24 | -2.20A | -0.86 |
| 3Q EPS | -1.84 | -2.01 | -0.84 |
| 4Q EPS | -3.87 | -2.10 | -0.93 |
| FY EPS (EUR) | -8.14 | -7.38 | -3.40 |
| OLD FY EPS (EUR) | -8.14 | -7.38 | -3.39 |
| % Change | -0.0% | 0.0% | 0.2% |
| P/E (x) | - | - | - |
| DPS (EUR) | 0.00 | 0.00 | 0.00 |
| Dividend yield (%) | - | 0.0 | 0.0 |
| Revenue (EURm) | 4,090.0 | 5,256.6 | 6,762.5 |

Source: Deutsche Bank estimates, company data

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3Q18 Preview

Figure 1: Summary of estimate changes

| EUR in M | 3Q18E | | | | 4Q18E | | | | 2018E | | | | 2019E | | | | 2020E | | | | 2021E | | | | |
|--|----------------|----------------|----------|----------------|----------------|----------------|---------|----------------|----------------|----------------|--------|----------------|----------------|----------------|---------|----------------|----------------|----------------|--------|----------------|----------------|----------------|--------|-----------------|-----------------|
| | New Est. | Old Est. | Delta | Street | New Est. | Old Est. | Delta | Street | DBe | Old Est. | Delta | Street | DBe | Old Est. | Delta | Street | DBe | Old Est. | Delta | Street | DBe | Old Est. | Delta | Street | |
| Users (M) | | | | | | | | | | | | | | | | | | | | | | | | | |
| Monthly Active Users (MAUs) | 191 | 191 | 0.0% | | 204 | 204 | 0.0% | | 204 | 204 | 0.0% | | 253 | 253 | 0.0% | | 307 | 307 | 0.0% | | 359 | 359 | 0.0% | | |
| Premium Subscribers | 87 | 87 | 0.0% | 87 | 96 | 96 | 0.0% | 96 | 96 | 0.0% | 96 | 123 | 123 | 0.0% | 123 | 150 | 150 | 0.0% | 152 | 177 | 177 | 0.0% | 181 | 181 | |
| Ad-Supported MAUs | 109 | 109 | 0.0% | 107 | 112 | 112 | 0.0% | 111 | 112 | 112 | 0.0% | 111 | 137 | 137 | 0.0% | 135 | 165 | 165 | 0.0% | 159 | 190 | 190 | 0.0% | 182 | 182 |
| Total Revenue (M) | € 1,123 | € 1,137 | | € 1,136 | € 1,522 | € 1,508 | | € 1,492 | € 5,257 | € 5,257 | 0.0% | € 5,247 | € 6,735 | € 6,708 | 0.8% | € 6,735 | € 8,244 | € 8,178 | 0.8% | € 8,440 | € 9,964 | € 9,883 | 0.8% | € 10,294 | € 10,294 |
| Growth (Y/Y) | 28.2% | 29.6% | -137 bps | 29.4% | 32.4% | 31.2% | 121 bps | 29.8% | 28.5% | 28.5% | 00 bps | 28.3% | 28.6% | 27.6% | 104 bps | 28.4% | 21.9% | 21.9% | 00 bps | 25.3% | 20.9% | 20.9% | 00 bps | 22.0% | 22.0% |
| Premium | € 1,181 | € 1,195 | -1.2% | € 1,197 | € 1,353 | € 1,339 | 1.0% | € 1,322 | € 4,721 | € 4,721 | 0.0% | € 4,711 | € 6,090 | € 6,036 | 0.9% | € 6,019 | € 7,439 | € 7,373 | 0.9% | € 7,497 | € 9,014 | € 8,934 | 0.9% | € 9,178 | € 9,178 |
| Ad-Supported | 142 | 142 | 0.0% | 140 | 169 | 169 | 0.0% | 170 | 536 | 536 | 0.0% | 535 | 672 | 672 | 0.0% | 720 | 805 | 805 | 0.0% | 922 | 950 | 950 | 0.0% | 1,081 | 1,081 |
| Premium COGS | 877 | 888 | -1.2% | | 993 | 983 | 1.0% | | 3,478 | 3,478 | 0.0% | | 4,396 | 4,357 | 0.9% | | 5,258 | 5,211 | 0.9% | | 6,371 | 6,315 | 0.9% | | 6,315 |
| Ad-Supported COGS | 115 | 115 | 0.0% | | 135 | 135 | 0.0% | | 442 | 442 | 0.0% | | 545 | 545 | 0.0% | | 643 | 643 | 0.0% | | 746 | 746 | 0.0% | | 746 |
| Total Gross Profits | 331 | 334 | -1.1% | 332 | 393 | 389 | 1.0% | 387 | 1,336 | 1,336 | 0.0% | 1,333 | 1,821 | 1,806 | 0.8% | 1,806 | 2,343 | 2,324 | 0.8% | 2,388 | 2,846 | 2,822 | 0.8% | 3,054 | 3,054 |
| Premium | 304 | 307 | -1.2% | | 359 | 356 | 1.0% | | 1,242 | 1,242 | 0.0% | | 1,694 | 1,679 | 0.9% | | 2,181 | 2,162 | 0.9% | | 2,643 | 2,619 | 0.9% | | 2,619 |
| Ad-Supported | 27 | 27 | 0.0% | | 34 | 34 | 0.0% | | 94 | 94 | 0.0% | | 127 | 127 | 0.0% | | 162 | 162 | 0.0% | | 203 | 203 | 0.0% | | 203 |
| Total Gross Margins | 25.0% | 25.0% | -01 bps | 24.9% | 25.84% | 25.8% | 01 bps | 25.93% | 25.4% | 25.4% | 00 bps | 25.4% | 26.9% | 26.9% | 01 bps | 26.8% | 28.4% | 28.4% | 01 bps | 28.3% | 28.6% | 28.6% | 01 bps | 28.7% | 28.7% |
| Premium | 25.7% | 25.7% | 00 bps | | 26.6% | 26.6% | 00 bps | | 26.3% | 26.3% | 00 bps | | 27.8% | 27.8% | 00 bps | | 29.3% | 29.3% | 00 bps | | 29.3% | 29.3% | 00 bps | | 29.3% |
| Ad-Supported | 19.0% | 19.0% | 00 bps | | 20.0% | 20.0% | 00 bps | | 17.5% | 17.5% | 00 bps | | 18.9% | 18.9% | 00 bps | | 20.2% | 20.2% | 00 bps | | 21.4% | 21.4% | 00 bps | | 21.4% |
| Operating Costs: | | | | | | | | | | | | | | | | | | | | | | | | | |
| Research and development | € 150 | € 152 | -1.1% | € 140 | € 171 | € 169 | 0.9% | € 162 | € 579 | € 579 | 0.0% | € 561 | € 761 | € 755 | 0.8% | € 734 | € 928 | € 921 | 0.8% | € 948 | € 1,126 | € 1,117 | 0.8% | € 1,175 | € 1,175 |
| Sales and marketing | 163 | 165 | -1.1% | 164 | 216 | 216 | 0.9% | 203 | 693 | 692 | 0.0% | 679 | 890 | 883 | 0.8% | 820 | 1,084 | 1,076 | 0.8% | 958 | 1,238 | 1,228 | 0.8% | 1,128 | 1,128 |
| General and administrative | 79 | 80 | -1.1% | 80 | 87 | 86 | 0.9% | 85 | 340 | 340 | 0.0% | 337 | 350 | 347 | 0.8% | 384 | 407 | 403 | 0.8% | 444 | 470 | 466 | 0.8% | 483 | 483 |
| Total Operating Costs | 393 | 397 | -1.1% | 385 | 476 | 471 | 0.9% | 450 | 1,612 | 1,611 | 0.0% | 1,577 | 2,002 | 1,986 | 0.8% | 1,939 | 2,419 | 2,400 | 0.8% | 2,350 | 2,834 | 2,811 | 0.8% | 2,834 | 2,834 |
| GAAP Operating Income | (62) | (63) | -0.9% | | (82) | (82) | 0.8% | | (275) | (275) | 0.0% | (190) | (180) | (179) | 0.5% | (104) | (76) | (76) | 0.0% | 88 | 12 | 12 | 6.0% | #N/A | #N/A |
| Adjusted EBITDA | (33) | (33) | -0.9% | (23) | (49) | (48) | 0.8% | (35) | (154) | (154) | 0.1% | (131) | (27) | (27) | -0.2% | (8) | 108 | 107 | 1.2% | 175 | 241 | 238 | 1.0% | 477 | 477 |
| Adjusted EBITDA Margin % | | | | | | | | | | | | | | | | | | | | | | | | | |
| Income (Loss) Before Income Taxes | (364) | (365) | -0.2% | | (384) | (384) | 0.2% | | (1,320) | (1,320) | 0.0% | | (632) | (631) | 0.2% | | (528) | (528) | 0.0% | | (440) | (440) | -0.2% | | (440) |
| Tax Rate | 0.0% | 0.0% | 0.0% | | 0.0% | 0.0% | 0.0% | | 0.7% | 0.7% | 0.0% | | 0.0% | 0.0% | 0.0% | | 0.0% | 0.0% | 0.0% | | 0.0% | 0.0% | 0.0% | | 0.0% |
| Net loss attributable to owners the parent | (€ 364) | (€ 365) | -0.2% | | (€ 384) | (€ 384) | 0.2% | | (€ 1,311) | (€ 1,311) | 0.0% | | (€ 632) | (€ 631) | 0.2% | | (€ 528) | (€ 528) | 0.0% | | (€ 440) | (€ 440) | -0.2% | | (€ 440) |
| Basic EPS | (€ 2.01) | (€ 2.02) | -0.2% | | (€ 2.10) | (€ 2.10) | 0.2% | | (€ 7.38) | (€ 7.38) | 0.0% | | (€ 3.40) | (€ 3.39) | 0.2% | | (€ 2.77) | (€ 2.77) | 0.0% | | (€ 2.26) | (€ 2.27) | -0.2% | | (€ 2.26) |
| Diluted EPS | (€ 2.01) | (€ 2.02) | -0.2% | (€ 0.28) | (€ 2.10) | (€ 2.10) | 0.2% | (€ 0.32) | (€ 7.38) | (€ 7.38) | 0.0% | (€ 3.80) | (€ 3.40) | (€ 3.39) | 0.2% | (€ 0.66) | (€ 2.77) | (€ 2.77) | 0.0% | € 0.23 | (€ 2.26) | (€ 2.27) | -0.2% | € 1.63 | € 1.63 |
| Shares Outstanding (Fully Diluted) | 203 | 205 | -0.1% | | 205 | 207 | -1.2% | | 194 | 196 | -0.9% | | 208 | 211 | -1.1% | | 213 | 215 | -1.1% | | 216 | 219 | -1.1% | | 219 |
| Free Cash Flow (FCF - Capex) | 6 | 20 | -69.1% | 28 | 138 | 110 | 24.8% | 96 | 236 | 223 | 6.1% | 208 | 301 | 298 | 1.0% | 300 | 366 | 363 | 1.0% | 558 | 628 | 619 | 0.9% | 941 | 941 |

Source: Company Reports; Deutsche Bank Securities, Inc.

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Valuation

HOLD rated with \$154 Price Target (from \$189)

Our \$154 price target (from \$189) is based on a combination of EV/revenue multiple of 3x (from 4x previously), an EV/gross profit multiple of 12.5x (from 16x previously) and a DCF analysis with a terminal multiple of 20x FCF (unchanged). We reduce these multiples to reflect peer group multiple contraction and continue to use a 25% discount to Netflix on EV/gross profit.

Figure 2: Valuation

Spotify Technology S.A.

(USD in mn unless noted)

| | | | | |
|---|--------------|--------------|--------------|--------------|
| Current Price | \$141.68 | 10/23/2018 | | |
| Basic shares | 179.1 | | | |
| Diluted Shares Outstanding | 201.2 | | | |
| Current Market Cap | 28,500.5 | | | |
| Less: Cash and Cash Equivalents | 1,971.8 | | | |
| Less: equity investments | 1,126.1 | | | |
| Plus: Minority interest | - | | | |
| Plus: Debt (excl convert in equity) | - | | | |
| Adjusted Enterprise Value | 25,403 | | | |
| <i>EUR/USD FX Assumptions</i> | | 1.13 | 1.18 | 1.14 |
| | | 1.14 | | |
| EV to Revenue | | 2017A | 2018E | 2019E |
| | | 2020E | | |
| Revenue | \$4,621 | \$6,205 | \$7,691 | \$9,376 |
| Current EV/Revenue Multiple | 5.5x | 4.1x | 3.3x | 2.7x |
| Target Multiple | 3.0x | 3.0x | 3.0x | 3.0x |
| Enterprise Value | \$13,863 | \$18,615 | \$23,073 | \$28,128 |
| Plus: YE Cash | 1,705 | 2,171 | 2,434 | 2,931 |
| Less: YE Debt | - | - | - | - |
| Plus: Investments / hidden assets | 1,126 | 1,126 | 1,126 | 1,126 |
| Equity Market Capitalization | 16,694 | 21,912 | 26,633 | 32,185 |
| FY End Projected Sharecount | 152 | 194 | 208 | 213 |
| Implied Stock Price on Forward Revenue | \$110 | \$113 | \$128 | \$151 |
| EV to Gross Profit | | 2017A | 2018E | 2019E |
| | | 2020E | | |
| Gross Profit | \$959 | \$1,577 | \$2,071 | \$2,665 |
| Current EV/Gross Profit Multiple | 26.5x | 16.1x | 12.3x | 9.5x |
| Target Multiple | 12.5x | 12.5x | 12.5x | 12.5x |
| Enterprise Value | \$11,990 | \$19,716 | \$25,894 | \$33,313 |
| Plus: YE Cash | 1,705 | 2,171 | 2,434 | 2,931 |
| Less: YE Debt | - | - | - | - |
| Plus: Investments / hidden assets | 1,126 | 1,126 | 1,126 | 1,126 |
| Equity Market Capitalization | 14,821 | 23,013 | 29,454 | 37,370 |
| FY End Projected Sharecount | 152 | 194 | 208 | 213 |
| Implied Stock Price on Gross Profit | \$98 | \$119 | \$141 | \$176 |
| Discounted Cash Flow Analysis | | \$167 | | |
| FCF Yield | | 2017A | 2018E | 2019E |
| | | 2020E | | |
| FCF per Share | \$0.81 | \$1.44 | \$1.64 | \$1.96 |
| Current FCF Yield | 0.6% | 1.0% | 1.2% | 1.4% |
| Target Price | | | | \$154 |

Source: Note: Convertible debt treated as equity.

Source: Company Reports; Deutsche Bank Securities, Inc.

Risks

Risks include: Upside risks include faster sub growth/better margins. Downside risks include increasing competition, lower than expect sub growth and supply concentration.

Figure 3: Summary of income statement

| Spotify Technology S.A. – Quarterly Earnings Analysis (€ in millions except per share amounts) | 2017A | | | | | | | | 2018E | | | | | | | | | | |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|---------------|---------------|
| | 2015A | 2016A | Mar A 1QA | Jun A 2QA | Sep A 3QA | Dec A 4QA | 2017A | Mar A 1QA | Jun A 2QA | Sep E 3QE | Dec E 4QE | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E | 2025E |
| Monthly Active Users (MAUs) | 91 | 123 | 132 | 138 | 150 | 160 | 160 | 173 | 180 | 191 | 204 | 204 | 253 | 307 | 359 | 405 | 449 | 489 | 527 |
| Premium Subscribers | 28 | 48 | 52 | 59 | 62 | 71 | 71 | 75 | 83 | 87 | 96 | 96 | 123 | 150 | 177 | 203 | 227 | 250 | 272 |
| Ad-Supported MAUs | 64 | 77 | 83 | 82 | 91 | 92 | 92 | 99 | 101 | 109 | 112 | 112 | 137 | 165 | 190 | 213 | 233 | 251 | 268 |
| Premium | € 1,744 | € 2,657 | € 828 | € 904 | € 923 | € 1,019 | € 3,674 | € 1,037 | € 1,150 | € 1,181 | € 1,353 | € 4,721 | € 6,090 | € 7,439 | € 9,014 | € 10,586 | € 12,221 | € 13,843 | € 15,464 |
| Ad-Supported | 196 | 295 | 74 | 103 | 109 | 130 | 416 | 102 | 123 | 142 | 169 | 536 | 672 | 805 | 950 | 1079 | 1203 | 1323 | 1442 |
| Total Revenue | 1,940 | 2,952 | 902 | 1,007 | 1,032 | 1,149 | 4,090 | 1,139 | 1,273 | 1,323 | 1,522 | 5,257 | 6,763 | 8,244 | 9,964 | 11,665 | 13,424 | 15,166 | 16,906 |
| Premium | 1,487 | 2,221 | 710 | 686 | 711 | 761 | 2,868 | 767 | 841 | 877 | 993 | 3,478 | 4,396 | 5,258 | 6,371 | 7,482 | 8,516 | 9,473 | 10,389 |
| Ad-Supported | 227 | 330 | 87 | 89 | 91 | 106 | 373 | 89 | 103 | 115 | 135 | 442 | 545 | 643 | 746 | 835 | 915 | 990 | 1,061 |
| Total Cost of revenue | 1,714 | 2,551 | 797 | 775 | 802 | 867 | 3,241 | 866 | 944 | 992 | 1,129 | 3,920 | 4,941 | 5,901 | 7,118 | 8,317 | 9,431 | 10,463 | 11,451 |
| Premium | 257 | 436 | 118 | 218 | 212 | 258 | 806 | 270 | 309 | 304 | 359 | 1,242 | 1,694 | 2,181 | 2,643 | 3,104 | 3,705 | 4,370 | 5,075 |
| Ad-Supported | (31) | (35) | (13) | 14 | 18 | 24 | 43 | 13 | 20 | 27 | 34 | 94 | 127 | 162 | 203 | 245 | 287 | 333 | 381 |
| Total Gross Profits | 226 | 401 | 105 | 232 | 230 | 282 | 849 | 283 | 329 | 331 | 393 | 1,336 | 1,821 | 2,343 | 2,846 | 3,348 | 3,993 | 4,703 | 5,466 |
| Operating Costs: | | | | | | | | | | | | | | | | | | | |
| Research and development | 136 | 207 | 80 | 95 | 98 | 123 | 396 | 115 | 143 | 150 | 171 | 579 | 761 | 928 | 1,126 | 1,324 | 1,530 | 1,735 | 1,942 |
| Sales and marketing | 219 | 368 | 110 | 146 | 138 | 173 | 567 | 138 | 173 | 163 | 218 | 693 | 890 | 1,084 | 1,238 | 1,365 | 1,473 | 1,554 | 1,609 |
| General and administrative | 106 | 175 | 54 | 70 | 67 | 73 | 264 | 71 | 103 | 79 | 87 | 340 | 350 | 407 | 470 | 530 | 587 | 637 | 682 |
| Total Operating Costs | 461 | 750 | 244 | 311 | 303 | 369 | 1,227 | 324 | 419 | 393 | 476 | 1,612 | 2,002 | 2,419 | 2,834 | 3,219 | 3,589 | 3,926 | 4,233 |
| GAAP Operating Income | (235) | (349) | (139) | (79) | (73) | (87) | (378) | (41) | (90) | (62) | (82) | (275) | (180) | (76) | 12 | 130 | 403 | 777 | 1,223 |
| Depreciation & amortization | 30 | 38 | 14 | 12 | 15 | 13 | 54 | 11 | 6 | 3 | 3 | 23 | 28 | 31 | 34 | 36 | 38 | 40 | 40 |
| Share-based payments expense | 28 | 53 | 14 | 19 | 16 | 16 | 65 | 18 | 23 | 26 | 30 | 98 | 126 | 153 | 195 | 240 | 290 | 342 | 399 |
| Adjusted EBITDA | (177) | (258) | (111) | (48) | (42) | (58) | (259) | (12) | (61) | (33) | (49) | (154) | (27) | 108 | 241 | 406 | 731 | 1,169 | 1,662 |
| Finance income | 36 | 152 | 27 | 41 | 14 | 36 | 118 | 15 | 41 | 41 | 41 | 138 | 164 | 164 | 164 | 164 | 164 | 164 | 164 |
| Finance costs | (26) | (336) | (62) | (148) | (219) | (545) | (974) | (154) | (343) | (343) | (343) | (1,183) | (616) | (616) | (616) | (616) | (616) | (616) | (616) |
| Share in (losses)/earnings of associates and joint ventures | 0 | (2) | 2 | (1) | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Finance income/(costs)—net | 10 | (186) | (3) | (108) | (205) | (509) | (855) | (139) | (302) | (302) | (302) | (1,045) | (452) | (452) | (452) | (452) | (452) | (452) | (452) |
| Income (Loss) Before Income Taxes | (225) | (535) | (172) | (187) | (278) | (596) | (1,233) | (180) | (392) | (364) | (384) | (1,320) | (632) | (528) | (440) | (322) | (49) | 325 | 771 |
| Income tax expense | (5) | (4) | (1) | (1) | 0 | 0 | (2) | 11 | (2) | 0 | 0 | 9 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Tax Rate | (2.2%) | (0.7%) | (0.6%) | (0.5%) | 0.0% | 0.0% | (0.2%) | 0.0% | 0.0% | 0.0% | 0.0% | 0.7% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Net loss attributable to owners the parent | (€ 230) | (€ 539) | (€ 173) | (€ 188) | (€ 278) | (€ 596) | (€ 1,235) | (€ 169) | (€ 394) | (€ 364) | (€ 384) | (€ 1,311) | (€ 632) | (€ 528) | (€ 440) | (€ 322) | (€ 49) | € 325 | € 771 |
| Income (loss) per share from continuing operations | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Basic EPS | (€ 1.62) | (€ 3.63) | (€ 1.15) | (€ 1.24) | (€ 1.84) | (€ 3.87) | (€ 8.14) | (€ 1.01) | (€ 2.20) | (€ 2.01) | (€ 2.10) | (€ 7.38) | (€ 3.40) | (€ 2.77) | (€ 2.26) | (€ 1.63) | (€ 0.24) | € 1.57 | € 3.66 |
| Diluted EPS | (€ 1.62) | (€ 3.63) | (€ 1.15) | (€ 1.24) | (€ 1.84) | (€ 3.87) | (€ 8.14) | (€ 1.01) | (€ 2.20) | (€ 2.01) | (€ 2.10) | (€ 7.38) | (€ 3.40) | (€ 2.77) | (€ 2.26) | (€ 1.63) | (€ 0.24) | € 1.42 | € 3.32 |
| Shares Outstanding (Basic) | 142 | 148 | 150 | 151 | 151 | 154 | 152 | 168 | 179 | 181 | 183 | 178 | 186 | 191 | 194 | 198 | 202 | 206 | 210 |
| Shares Outstanding (Fully Diluted) | 142 | 148 | 150 | 151 | 151 | 154 | 152 | 168 | 201 | 203 | 205 | 194 | 208 | 213 | 216 | 220 | 224 | 228 | 233 |
| Margin Analysis | | | | | | | | | | | | | | | | | | | |
| Gross Profit Margin | 12% | 14% | 12% | 23% | 22% | 25% | 21% | 25% | 26% | 25% | 26% | 25% | 27% | 28% | 29% | 29% | 30% | 31% | 32% |
| Research & Development as % of Revenue | 7% | 7% | 9% | 9% | 9% | 11% | 10% | 10% | 11% | 11% | 11% | 11% | 11% | 11% | 11% | 11% | 11% | 11% | 11% |
| Sales & Marketing as % of Revenue | 11% | 12% | 12% | 14% | 13% | 15% | 14% | 12% | 14% | 12% | 14% | 13% | 13% | 13% | 12% | 12% | 11% | 10% | 10% |
| General & Administrative as % of Revenue | 5% | 6% | 6% | 7% | 6% | 6% | 6% | 6% | 8% | 6% | 6% | 6% | 6% | 5% | 5% | 5% | 4% | 4% | 4% |
| Total Operating Expenses as % of Revenue | 24% | 25% | 27% | 31% | 29% | 32% | 30% | 28% | 33% | 30% | 31% | 31% | 30% | 29% | 28% | 28% | 27% | 26% | 25% |
| Operating Margin | (12%) | (12%) | (15%) | (8%) | (7%) | (8%) | (9%) | (4%) | (7%) | (5%) | (5%) | (5%) | (3%) | (1%) | 0% | 1% | 3% | 5% | 7% |
| Adjusted EBITDA Margin | (9%) | (9%) | (12%) | (5%) | (4%) | (5%) | (6%) | (1%) | (5%) | (2%) | (3%) | (3%) | (0%) | 1% | 2% | 3% | 5% | 8% | 10% |
| Incremental EBITDA Margin | (2%) | (8%) | (9%) | 7% | 1% | 1% | (0%) | 42% | (5%) | 3% | 3% | 9% | 8% | 9% | 3% | 4% | 6% | 9% | 18% |
| Year Over Year Growth | | | | | | | | | | | | | | | | | | | |
| Revenue | 79% | 52% | 46% | 41% | 38% | 32% | 39% | 26% | 26% | 28% | 32% | 29% | 29% | 22% | 21% | 17% | 15% | 13% | 11% |
| Cost of Revenues | 98% | 49% | 36% | 27% | 26% | 21% | 27% | 7% | 22% | 24% | 30% | 21% | 26% | 19% | 21% | 17% | 13% | 11% | 9% |
| Gross Profit | 30% | 77% | 239% | 123% | 104% | 84% | 112% | 170% | 42% | 44% | 39% | 57% | 36% | 29% | 21% | 18% | 19% | 18% | 16% |
| Operating Income | 23% | 49% | 32% | (13%) | 11% | 0% | 8% | (71%) | 13% | (15%) | (5%) | (27%) | (35%) | (58%) | (116%) | 961% | 211% | 93% | 57% |
| Adjusted EBITDA | 12% | 48% | 31% | (30%) | (5%) | (5%) | 0% | (89%) | 26% | (22%) | (16%) | (41%) | (83%) | (607%) | 123% | 89% | 80% | 58% | 43% |
| Reported Net Income | 22% | 134% | 24% | 2% | 114% | 601% | 129% | (2%) | 109% | 31% | (35%) | 6% | (52%) | (17%) | (27%) | (85%) | (767%) | 138% | 138% |
| GAAP Earnings per Share | 16% | 124% | 21% | (1%) | 112% | 582% | 124% | (13%) | 77% | 10% | (46%) | (9%) | (54%) | (18%) | (18%) | (28%) | (85%) | (690%) | 133% |

Source: Company Reports; Deutsche Bank Securities, Inc.



Figure 4: DCF summary

| (USD in millions, unless noted) | 2014 | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E | 2025E | '17E-'25E CAGR |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------|
| Premium Subs | 14 | 28 | 48 | 71 | 96 | 123 | 150 | 177 | 203 | 227 | 250 | 272 | 18.4% |
| Y/Y Growth | | 93.2% | 72.9% | 45.9% | 36.1% | 27.6% | 22.0% | 18.3% | 14.5% | 12.0% | 10.2% | 8.9% | |
| Revenues | \$1,442 | \$2,153 | \$3,268 | \$4,621 | \$6,205 | \$7,691 | \$9,376 | \$11,332 | \$13,267 | \$15,267 | \$17,249 | \$19,228 | 19.5% |
| Y/Y Growth | 45.5% | 49.3% | 51.7% | 41.4% | 34.3% | 23.9% | 21.9% | 20.9% | 17.1% | 15.1% | 13.0% | 11.5% | |
| Gross Margins | 16% | 12% | 14% | 21% | 25% | 27% | 28% | 29% | 29% | 30% | 31% | 32% | |
| Adj EBITDA | (\$210) | (\$196) | (\$286) | (\$293) | (\$182) | (\$30) | \$123 | \$274 | \$462 | \$832 | \$1,318 | \$1,890 | NM |
| Y/Y Growth | na | -6.4% | 45.4% | 2.5% | -37.9% | -83.4% | -507.0% | 122.7% | 68.6% | 80.2% | 58.5% | 43.4% | |
| EBITDA Margin | | -9.1% | -8.7% | -6.3% | -2.9% | -0.4% | 1.3% | 2.4% | 3.5% | 5.4% | 7.6% | 9.8% | |
| Incremental EBITDA Margin | | 1.9% | -8.0% | -0.5% | 7.0% | 10.2% | 9.1% | 7.7% | 9.7% | 18.5% | 24.5% | 28.9% | |
| D&A | \$25 | \$33 | \$42 | \$61 | \$28 | \$32 | \$35 | \$38 | \$41 | \$44 | \$45 | \$46 | -3.5% |
| % of revenue | 1.8% | 1.5% | 1.3% | 1.3% | 0.4% | 0.4% | 0.4% | 0.3% | 0.3% | 0.3% | 0.3% | 0.2% | |
| EBIT | (235.1) | (229.8) | (327.6) | (353.6) | (209.5) | (62.1) | 88.0 | 235.7 | 420.4 | 788.0 | 1,272.6 | 1,844.2 | NM |
| Taxes | (3.3%) | (2.2%) | (0.7%) | (0.2%) | 0.7% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 19.0% | |
| Tax Effective EBIT | (\$235) | (\$230) | (\$328) | (\$354) | (\$209) | (\$62) | \$88 | \$236 | \$420 | \$788 | \$1,273 | \$1,494 | |
| Tax-affected EBIT + DA | (\$210) | (\$196) | (\$286) | (\$293) | (\$182) | (\$30) | \$123 | \$274 | \$462 | \$832 | \$1,318 | \$1,540 | NM |
| Less: Change in net working capital | \$0 | \$191 | \$333 | \$498 | \$502 | \$405 | \$333 | \$483 | \$513 | \$515 | \$489 | \$414 | |
| Less: Capex | \$0 | (\$49) | (\$30) | (\$41) | (\$26) | (\$32) | (\$40) | (\$42) | (\$43) | (\$41) | (\$38) | (\$33) | |
| Unleveraged Fully-Taxed FCF | (\$210) | (\$54) | \$18 | \$165 | \$294 | \$342 | \$417 | \$715 | \$932 | \$1,305 | \$1,769 | \$1,920 | 35.9% |
| YoY Growth | | -74.1% | -132.6% | 831.4% | 78.3% | 16.4% | 21.7% | 71.6% | 30.4% | 40.1% | 35.5% | 8.6% | |
| uFCF Margin | -14.6% | -2.5% | 0.5% | 3.6% | 4.7% | 4.5% | 4.4% | 6.3% | 7.0% | 8.5% | 10.3% | 10.0% | |
| EBITDA-to-FCF Conversion | 100% | 28% | -6% | -56% | -162% | -1133% | 339% | 261% | 202% | 157% | 134% | 102% | |

| WACC Analysis | |
|-----------------------------|-------|
| Beta (estimated) | 1.25 |
| Equity risk premium | 5.25% |
| Risk free rate (5 yr Tnote) | 2.77% |
| Cost of equity | 9.33% |
| Cost of debt after tax | 5.27% |
| Target debt/capitalization | 25% |
| WACC | 8.32% |

| | |
|--|----------|
| Forward Free Cash Flow Multiple (2025) | 20.0x |
| Terminal Value (FCF Multiple) at YE 2024 | \$38,407 |
| Implied EV/EBITDA multiples on 2022 | 20.3x |

| | |
|---------------------------------|-----------------|
| NPV of Enterprise Value | \$25,408 |
| NPV of Cash Flow | 5,062 |
| TOTAL Value | \$30,470 |
| Less: Net Debt (Cash) | (2,526) |
| Plus: Long term investment | 1,126 |
| TOTAL Equity Value | \$34,123 |
| FD Shares Outstanding (YE 2018) | 204.8 |

| | |
|-------------------------------|--------------|
| Equity Value per Share | \$167 |
|-------------------------------|--------------|

Source: Company Reports; Deutsche Bank Securities, Inc.



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Appendix 1

Important Disclosures

*Other information available upon request

| Disclosure checklist | | | |
|----------------------|--------|--------------------------|------------|
| Company | Ticker | Recent price* | Disclosure |
| Spotify | SPOT.N | 141.68 (USD) 30 Oct 2018 | 14 |

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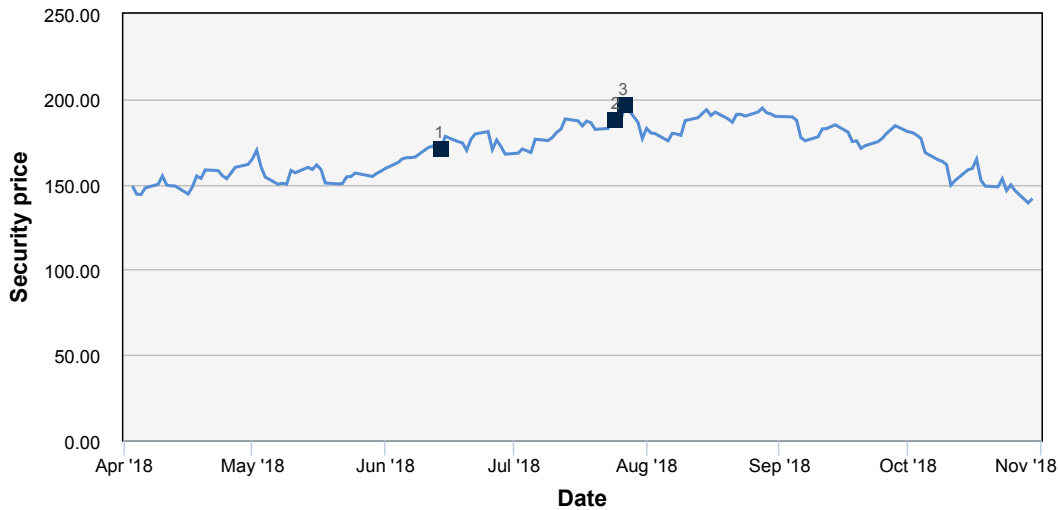
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Historical recommendations and target price. Spotify (SPOT.N)

(as of 10/30/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

- | | |
|---|---|
| 1. 06/14/2018 Hold, Target Price Change USD 155.00 Lloyd Walmsley | 3. 07/27/2018 Hold, Target Price Change USD 189.00 Lloyd Walmsley |
| 2. 07/25/2018 Hold, Target Price Change USD 170.00 Lloyd Walmsley | |

Equity Rating Key

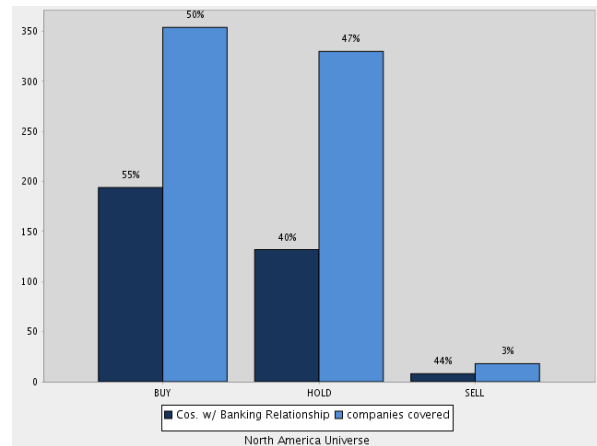
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships



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