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KMF Investments





**A PURE PAY-FOR-PERFORMANCE
PRIVATE INVESTMENT PARTNERSHIP**

WIDE MOAT INVESTING SUMMIT 2022
HOSTED BY MOI GLOBAL



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KMF INVESTMENTS

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- Structure and Strategy -

- | | |
|--|--|
| ➤ Long-term, Value-investing Approach: | ➤ Proven strategy: Define intrinsic value, stay within circle of competence, buy only if there is a large margin of safety |
| ➤ Nimble and Flexible Value Strategy: | ➤ Decision making streamlined in co-manager model to go where the value is (small cap, large cap, bonds, privates) |
| ➤ Pure Pay-for-Performance Model: | ➤ Still rather unique in the industry dominated by mutual funds constrained in scope, or the "2 & 20" hedge fund |
| ➤ Fair Structure and Aligned Objectives: | ➤ High water marks help ensure focus on 5+ year returns. Our families effectively "all-in", we eat our own cooking. |
| ➤ Clear Disclosures and Communications: | ➤ Portfolio grading approach helps partners exploit opportunities we see, helps us tune out market noise |
| ➤ Loyal Partner Base: | ➤ Strategy drives loyalty, even during peaks of market fear, which allows us to exploit bargains at the best times |

These are both our distinguishing features and our competitive advantages

KMF STRATEGY: FLAVORS OF VALUE WITH APPROPRIATE ENGAGEMENT MODELS



-
- FCF Based Valuations
- High Quality Buy and Hold
 - Future growth / GARP
 - Fixer-upper
 - Private Buyer Value
- Asset Based Valuations
- Resource Conversion
 - Below Replacement cost
 - Discount to Book-values
 - Net-Net Liquidation value
 - Break-up / Spin off values
- Special Situations
- Distressed Debt
 - Arbitrage

- Value Based Strategy -

Over the last 15 years, KMF has pursued a mix of all of these:

- The global financial crisis brought high quality companies down to great prices but also presented a number of special situations
- As investors chased momentum during most of last decade we focused more on quality and asset based opportunities
- Our asset / resource conversion plays served us well lately, but the recent market selloff is presenting GARP opportunities again

Different investment types require different engagement models

- Most of our investments are completely passive
- Some benefit from our “Friendly Advisor” approach
- Others result in more active engagement including board representation where we can influence capital allocation

CURRENT TECH DECLINE NOTABLE

MORE VALUE LOST THAN DOT-COM CRASH

NASDAQ market cap erased

Dot-com bubble

\$4.6 trillion

Global financial crisis

\$2.3 trillion

Covid-19 selloff

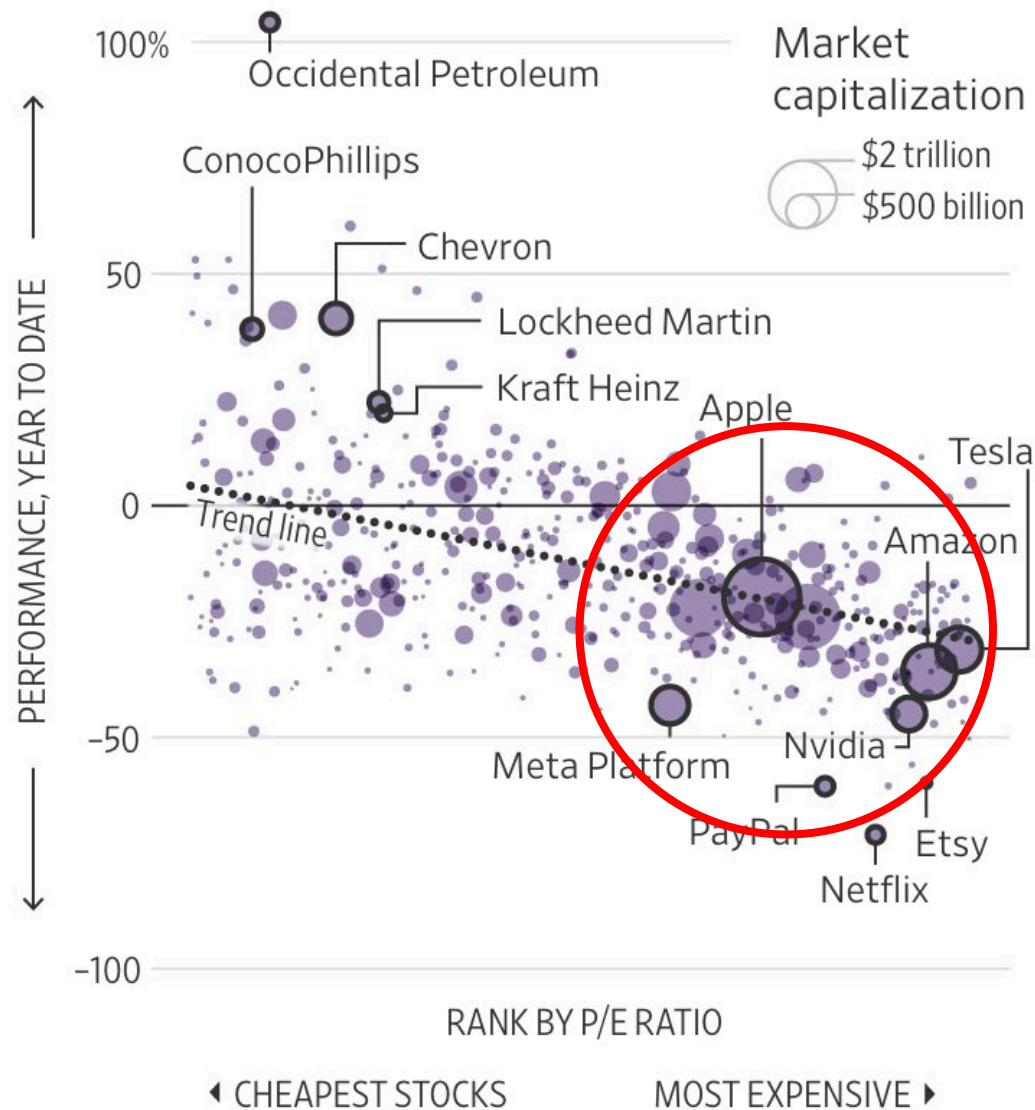
\$4.4 trillion

Current decline

\$7.6 trillion

CNBC: Through Mid-May, 2022

S&P 500 STOCKS: VALUATION VS. PERFORMANCE



**IS ANYTHING
THAT LOOKS
EXPENSIVE
ACTUALLY A
BARGAIN?**

#1 Audio Streaming Platform

Number of Subscribers:

182 Million

Number of Monthly Active Users:

422 Million

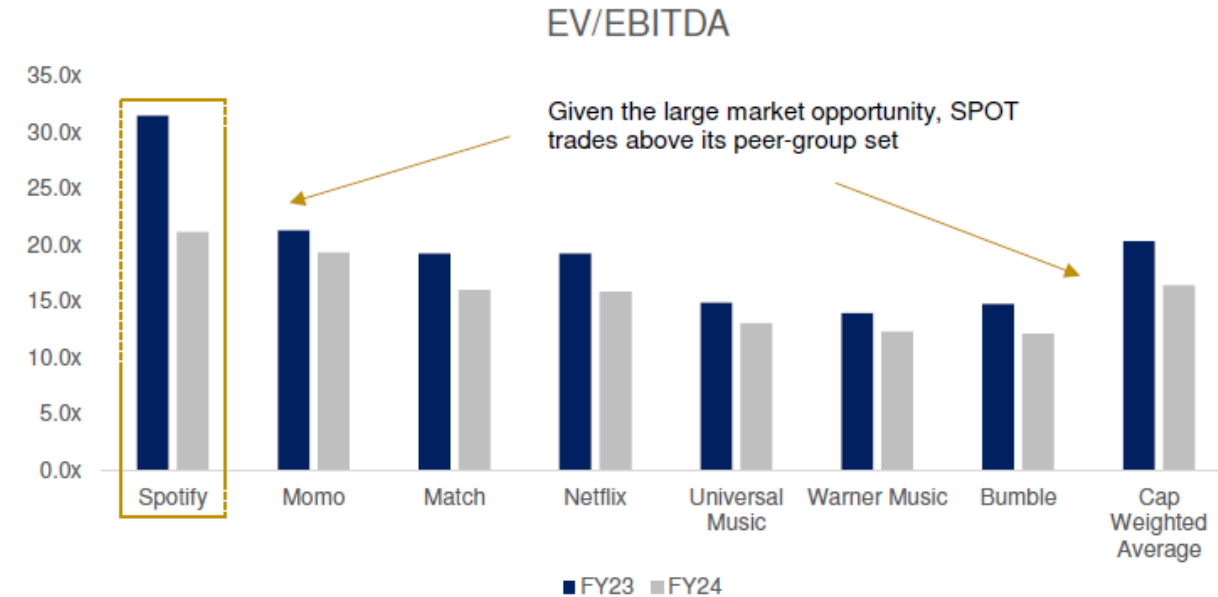
Number of tracks:

82 Million

Spotify is available in:

183 Markets

Optically, not that cheap



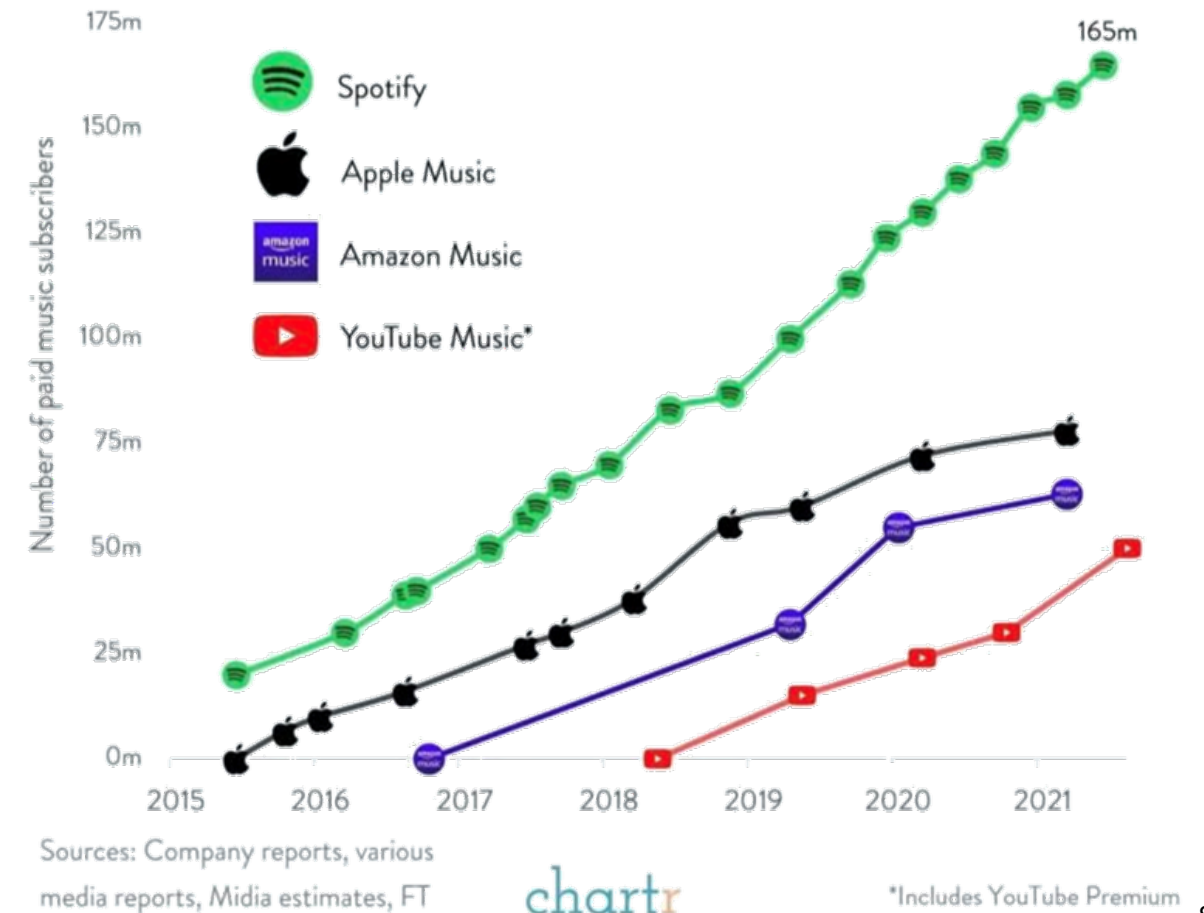
Source : Bloomberg Finance LP

IDEA INTRODUCTION



Spotify recently sold off below levels seen before the pandemic...

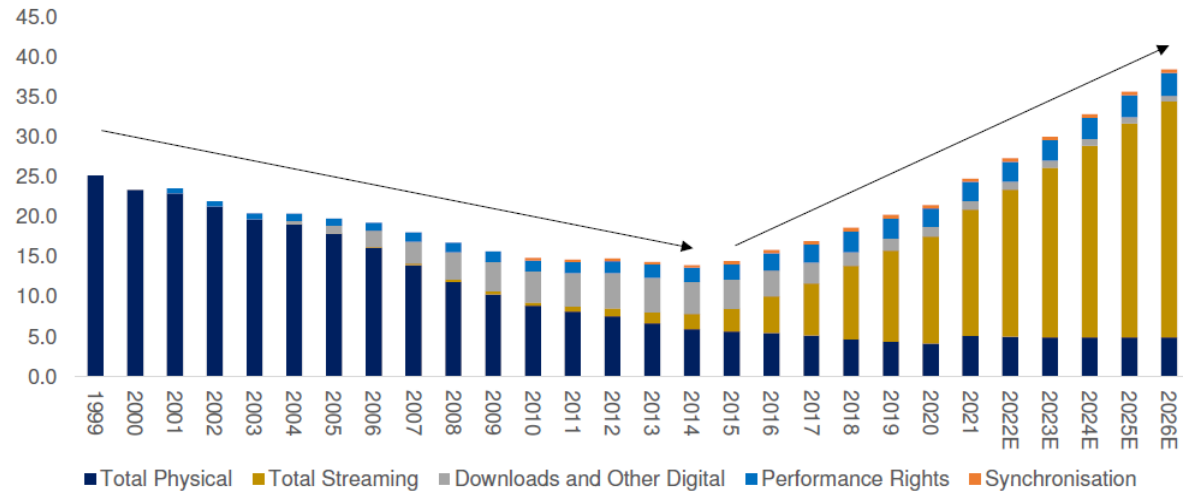
...Even as Spotify extends its lead in music streaming...



STREAMING SAVED THE MUSIC INDUSTRY

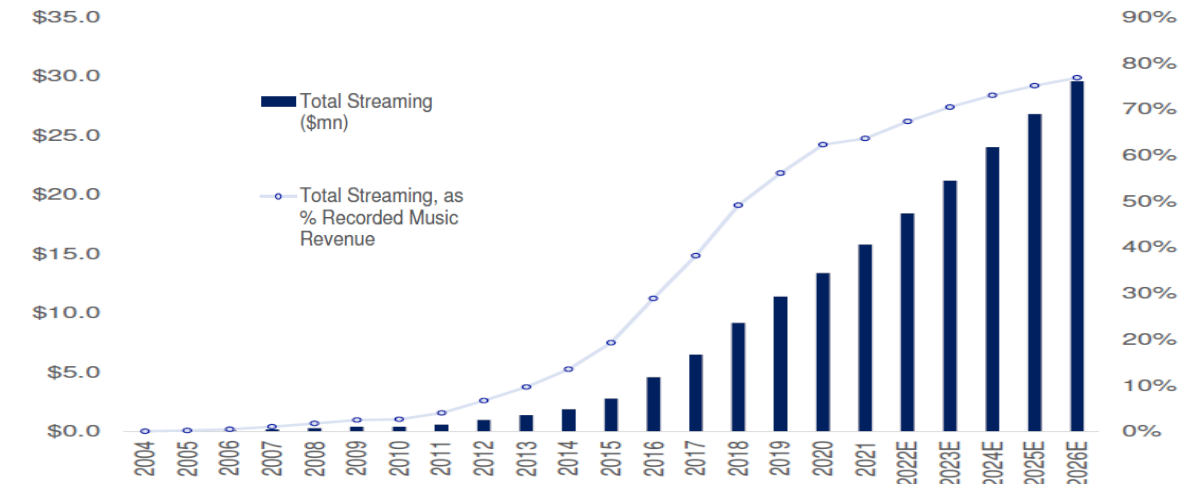
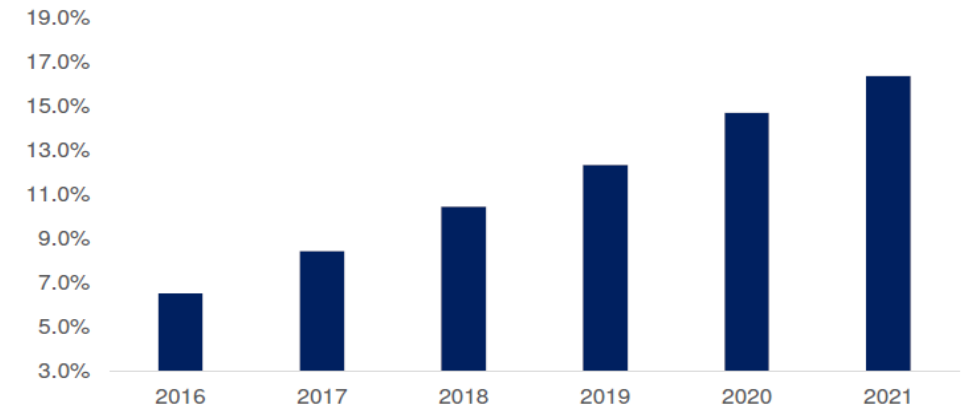
Industry revenues driven by streaming growth...

GLOBAL RECORDED MUSIC INDUSTRY REVENUES

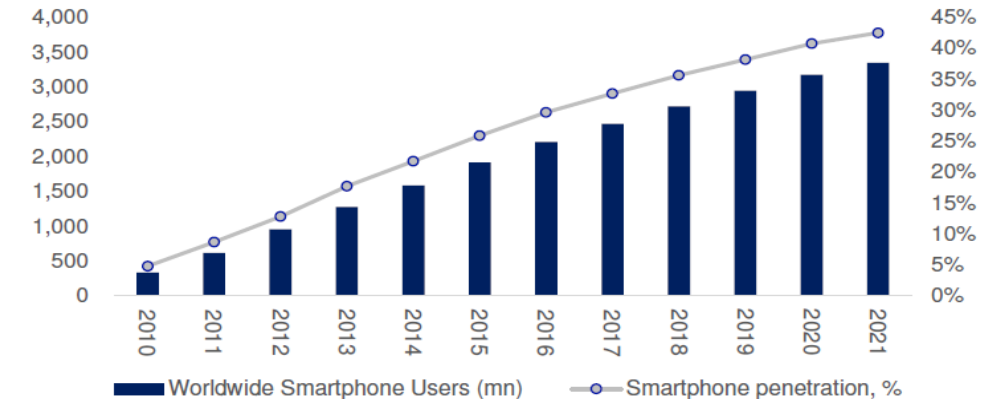


Penetration still has room to run...

Paid subscribers, penetration



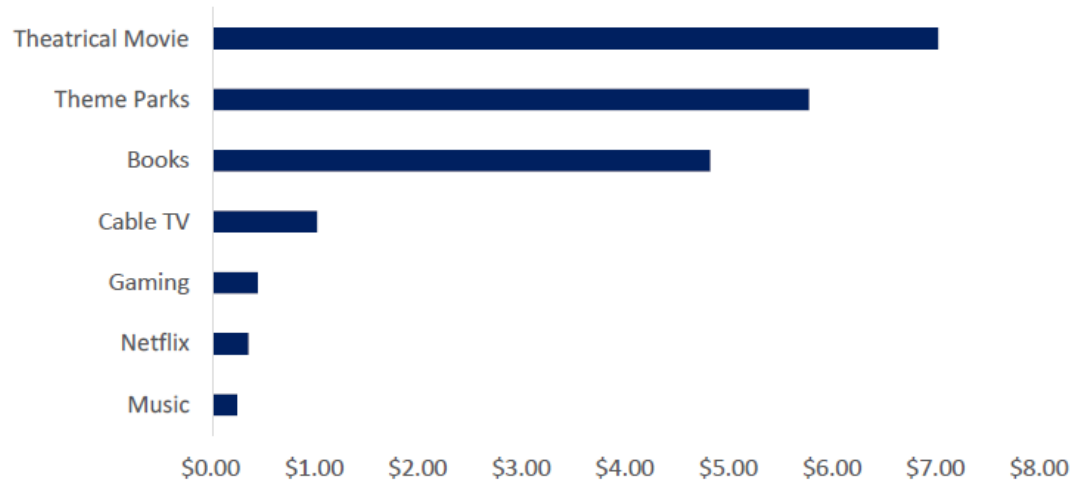
Smartphone penetration



MUSIC IS CHEAP ENTERTAINMENT

Music remains the cheapest source of entertainment...

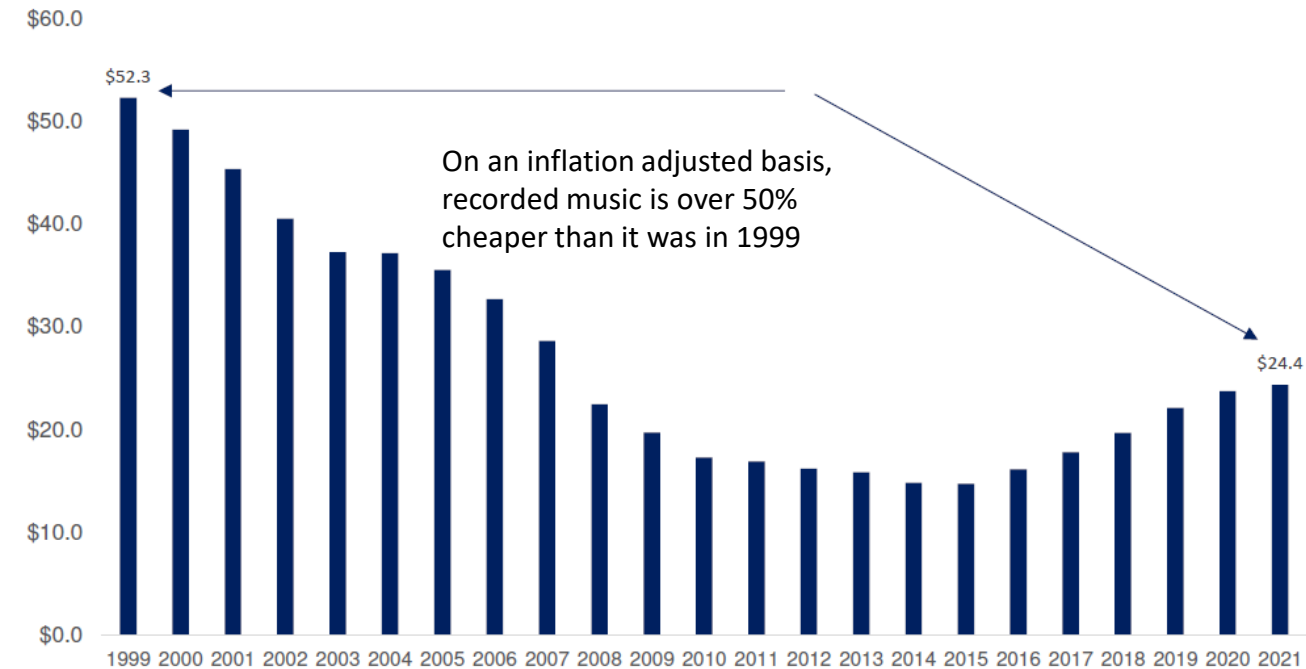
Cost per hour consumption hour



Source :Deutsche Bank Estimates

...and remains well below its inflation-adjusted peak levels

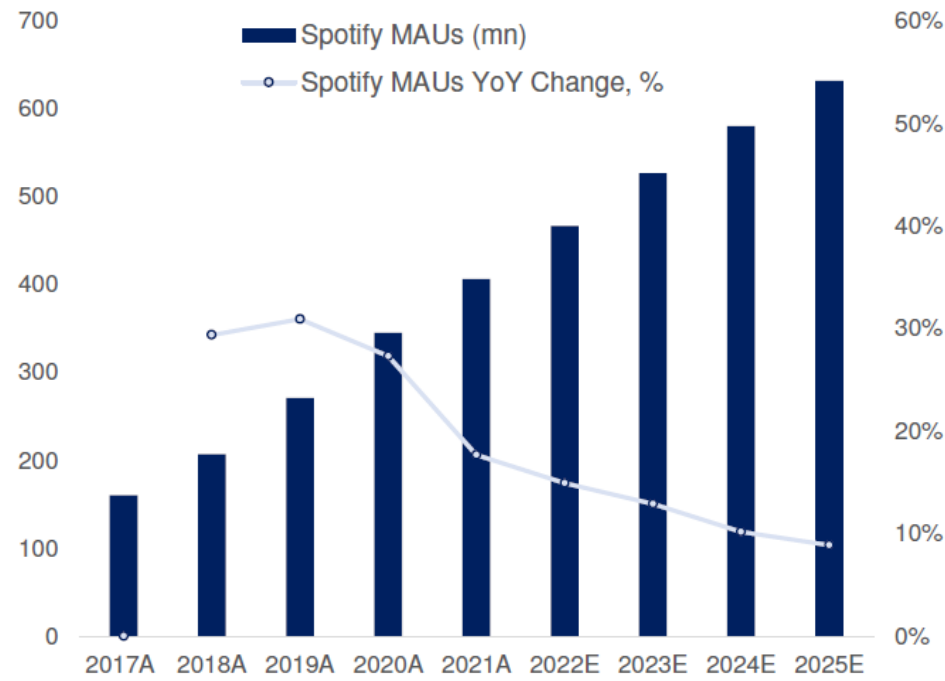
Inflation adjusted annual US recorded music revenue per capita



Source :IFPI, Deutsche Bank Analysis

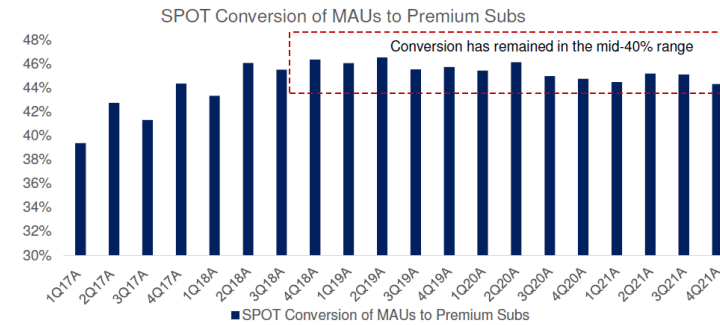
SPOTIFY HEADED TO 1B MAUs

Company points to 1B MAUs in the Medium Term...

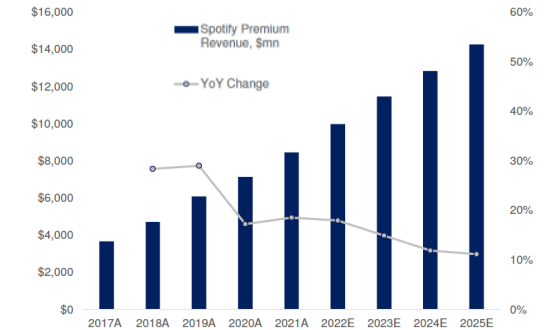


Source : Company reports and Deutsche Bank estimates

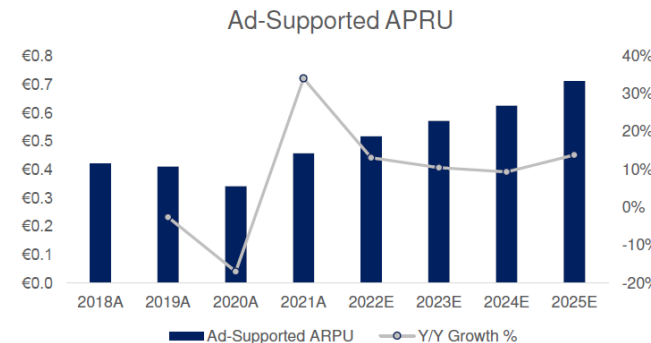
MAU Conversion to premium subs has been consistent, which should drive subscription revenues ...



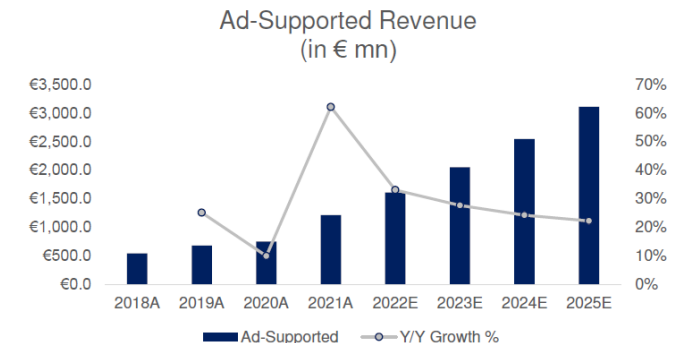
Source : Company reports and Deutsche Bank estimates



In addition to ad supported revenues ...



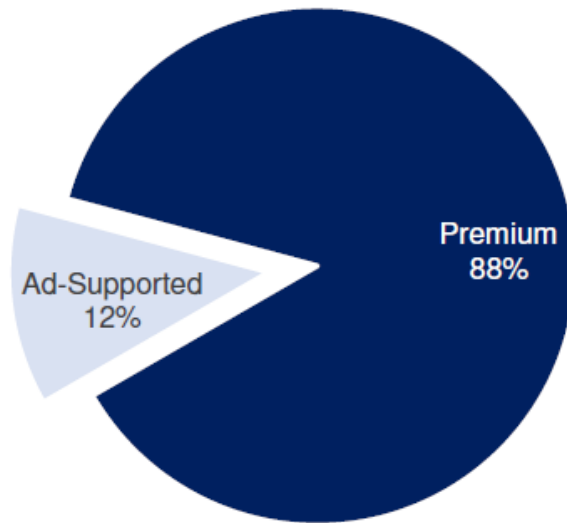
Source : Company reports, Deutsche Bank estimates



AD BUSINESS HAS SIGNIFICANT UPSIDE

Ads are a small part of the current Spotify revenue mix

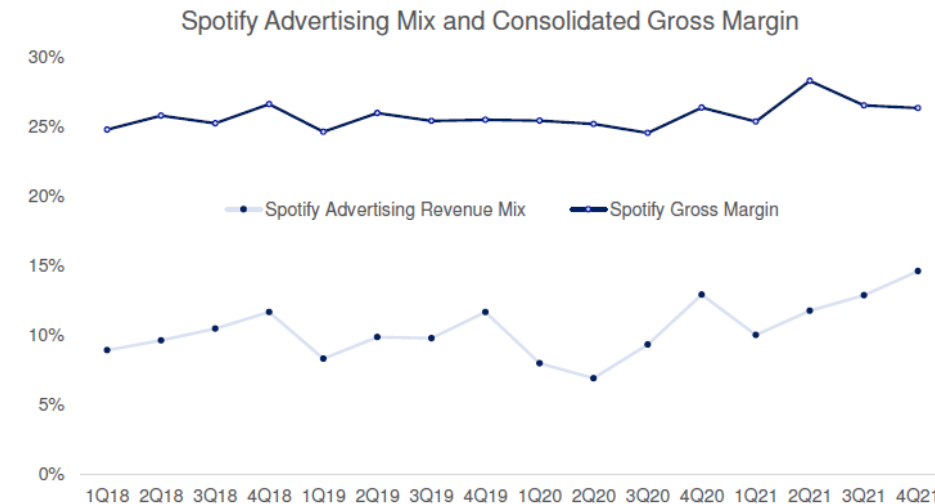
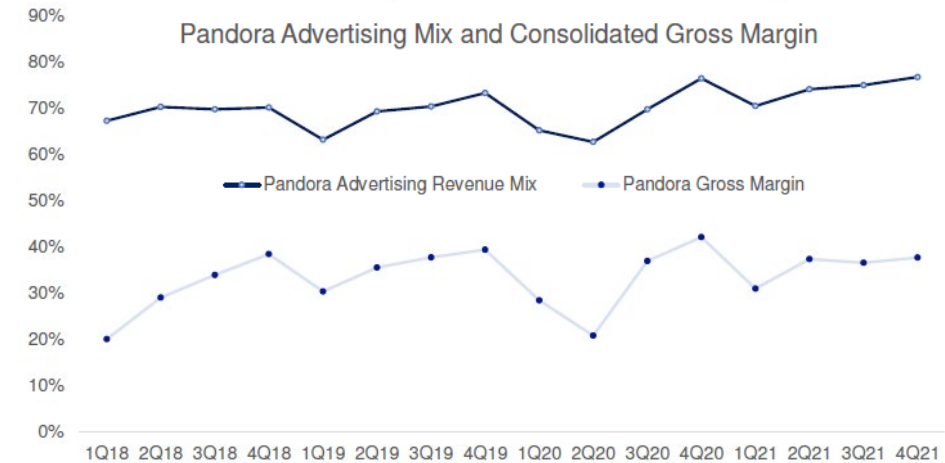
Spotify Revenue Composition, FY21

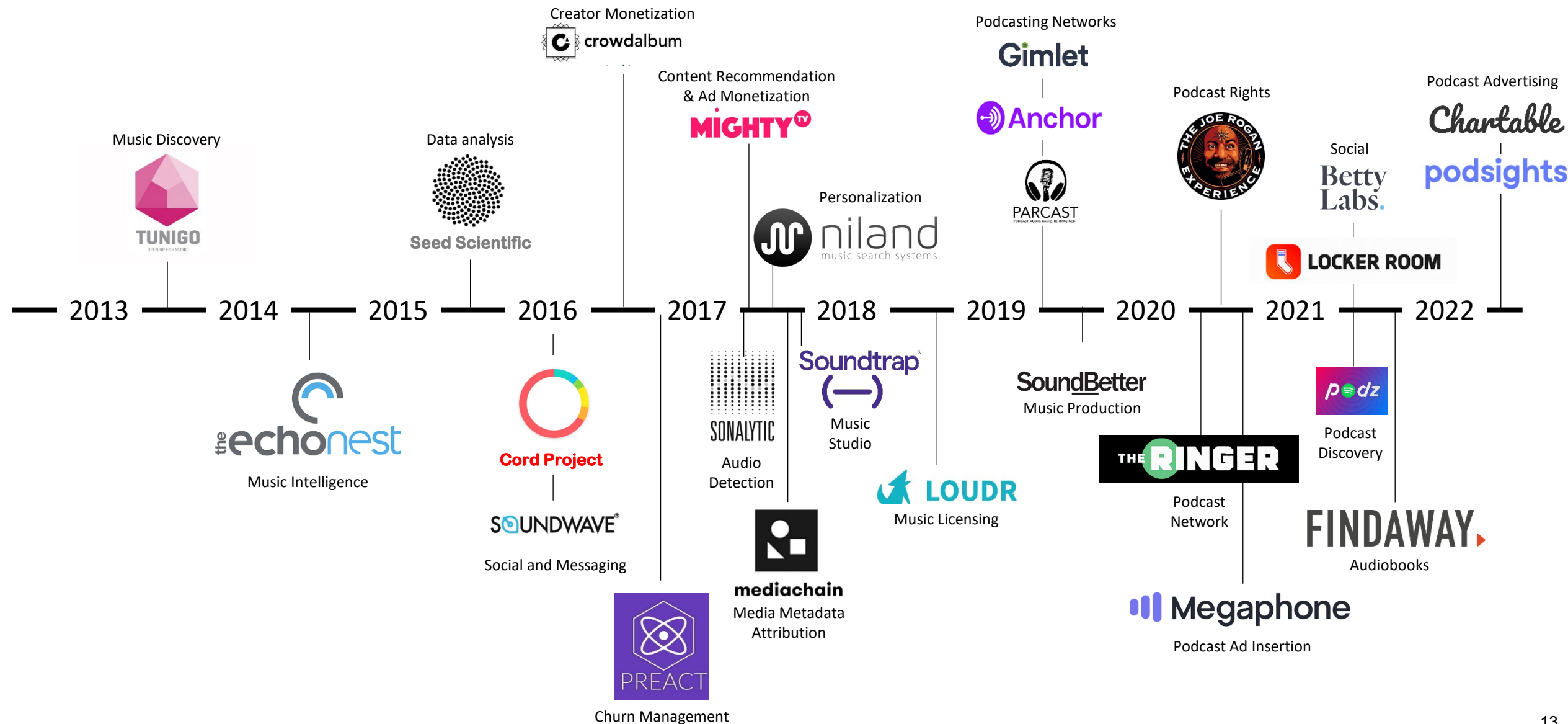


■ Premium ■ Ad-Supported

Source :Company reports and Deutsche Bank estimates

Compared to Pandora ad mix and gross margins, Spotify has significant room to grow this part of their business





INVESTING IN OWNED CONTENT

Spotify following proven content scaling model – acquire owned IP that attracts and scales across growing user base. Current investments are dragging down gross margins, and “free speech” dynamics have turned controversial in the COVID era.



OWNED CONTENT DRIVES SCALE

Spotify following proven content scaling model – acquire owned IP that attracts and scales across growing user base. Current investments are dragging down gross margins, and “free speech” dynamics have turned controversial in the COVID era.



- “The Joe Rogan Experience” is still the No. 1 show in 93 markets
- In 2021, Mr. Rogan’s show was the most-listened-to podcast every month in more than 30 markets
- Mr. Rogan’s listeners have grown by 75% from the time he joined Spotify’s platform in September 2020 to December 2021
- Mr. Rogan’s listeners are highly engaged; they return to Spotify to listen more, and listen to other content beyond his show
- Mr. Rogan’s show has been crucial to making Spotify the top U.S. podcast platform by listeners

Source: Audio data provider, Edison Research

INVESTING THRU THE INCOME STATEMENT

	December 31, 2021
Revenue	9,668
Cost of revenue	7,077
Gross profit	2,591
Research and development	912
Sales and marketing	1,135
General and administrative	450
	2,497
Operating (loss)/income	94
Finance income	246
Finance costs	(91)
Finance income/(costs) - net	155
(Loss)/income before tax	249
Income tax expense/(benefit)	283
Net (loss)/income attributable to owners of the parent	(34)
(Loss)/earnings per share attributable to owners of the parent	
Basic	(0.18)
Diluted	(1.03)
Weighted-average ordinary shares outstanding	
Basic	191,298,397
Diluted	193,943,455

Is most of this Growth Capex?

Is some of this Growth Capex?

A nuanced view of how Spotify is investing for growth can give insights into pro-forma metrics like “stand still free cash flow”

	2021A
Cash flows from operations	361
R&D Spend as Growth Capex	912
Sales and Marketing @ 20 %	227
Standstill FCF	1500
EUR / USD FX	1.07
Dollar Value	1605
No Growth Multiple	10X
No Growth Value	16050
Cash (\$)	2911
Shares	194
No Growth Value per Share	98

Potential Growth Drivers:

- MAU growth and conversion
- Ad stack monetization
- Pricing
- Label Renegotiations
- Mix shift toward independent artists

POTENTIAL VALUE

Current prices imply market believes SPOTs income statement investments will generate much lower returns than they have historically. Recent returns (~45%) have fallen to the 30% range with their ramp in podcast investments.

Starting Standstill FCF	\$ 1,500	GP less R&D and 20% of Sales and Marketing	
EUR/USD Conversion	\$ 1,605	@ 1.07	
Reinvestment Amount	1139	R&D + 20% of Sales and Marketing	
Implied Reinvestment Rate	76%	Reinvestment amount / Standstill FCF	
Shares Outstanding	194	million shares	
Terminal Value Multiple	10	times previous year Standstill Cash Earnings before Reinvestment	
Discount Rate	10%		

Return on Invested Capital

	10%	15%	20%	25%	30%	35%	40%	45%	
40%	\$ 79	\$ 91	\$ 105	\$ 121	\$ 140	\$ 162	\$ 187	\$ 216	Recent Implied Market Value
45%	\$ 79	\$ 93	\$ 109	\$ 128	\$ 151	\$ 178	\$ 210	\$ 247	
50%	\$ 78	\$ 94	\$ 113	\$ 136	\$ 163	\$ 196	\$ 236	\$ 283	Historical Levels
55%	\$ 78	\$ 95	\$ 117	\$ 144	\$ 177	\$ 217	\$ 266	\$ 325	
60%	\$ 77	\$ 97	\$ 121	\$ 153	\$ 191	\$ 240	\$ 299	\$ 373	
65%	\$ 76	\$ 98	\$ 126	\$ 162	\$ 208	\$ 265	\$ 338	\$ 428	
70%	\$ 76	\$ 100	\$ 131	\$ 172	\$ 225	\$ 294	\$ 381	\$ 492	
75%	\$ 75	\$ 101	\$ 136	\$ 183	\$ 245	\$ 325	\$ 430	\$ 564	
80%	\$ 74	\$ 103	\$ 142	\$ 195	\$ 266	\$ 361	\$ 485	\$ 648	

Implied Intrinsic Value per Share

BALANCE SHEET SAFETY

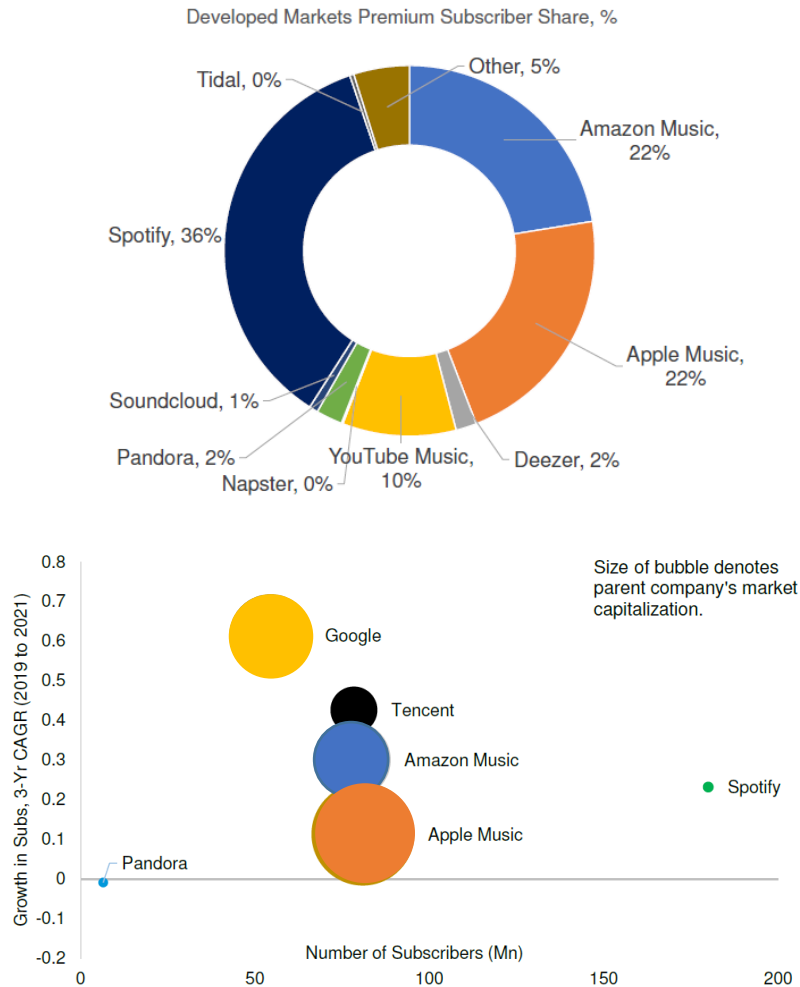
Unlike the “profitless” tech space which soared during the pandemic (and subsequently got torched), Spotify has more cash than debt and is free cash flow positive. This company is not Peloton or Nio...

(in € millions)	December 31, 2021
Assets	
Non-current assets	
Lease right-of-use assets	437
Property and equipment	372
Goodwill	894
Intangible assets	89
Long term investments	916
Restricted cash and other non-current assets	77
Deferred tax assets	13
	2,798
Current assets	
Trade and other receivables	621
Income tax receivable	5
Short term investments	756
Cash and cash equivalents	2,744
Other current assets	246
	4,372
Total assets	7,170
Equity and liabilities	
Equity	
Share capital	—
Other paid in capital	4,746
Treasury shares	(260)
Other reserves	853
Accumulated deficit	(3,220)
Equity attributable to owners of the parent	2,119

	December 31, 2021
Non-current liabilities	
Exchangeable Notes	1,202
Lease liabilities	579
Accrued expenses and other liabilities	37
Provisions	7
	1,825
Current liabilities	
Trade and other payables	793
Income tax payable	23
Deferred revenue	458
Accrued expenses and other liabilities	1,841
Provisions	22
Derivative liabilities	89
	3,226
Total liabilities	5,051
Total equity and liabilities	7,170

IS THERE A MOAT?

Competition is fierce and well funded. But, competition is not new, and Spotify lead seems to be getting bigger



Source : Bloomberg Finance LP, MIDiA Research, Deutsche Bank Estimates

Potential Moat

Low Cost Producer / Scale Moat

Brand Moat

Network Effect Moat

Switching Cost Moat

Patent Moat

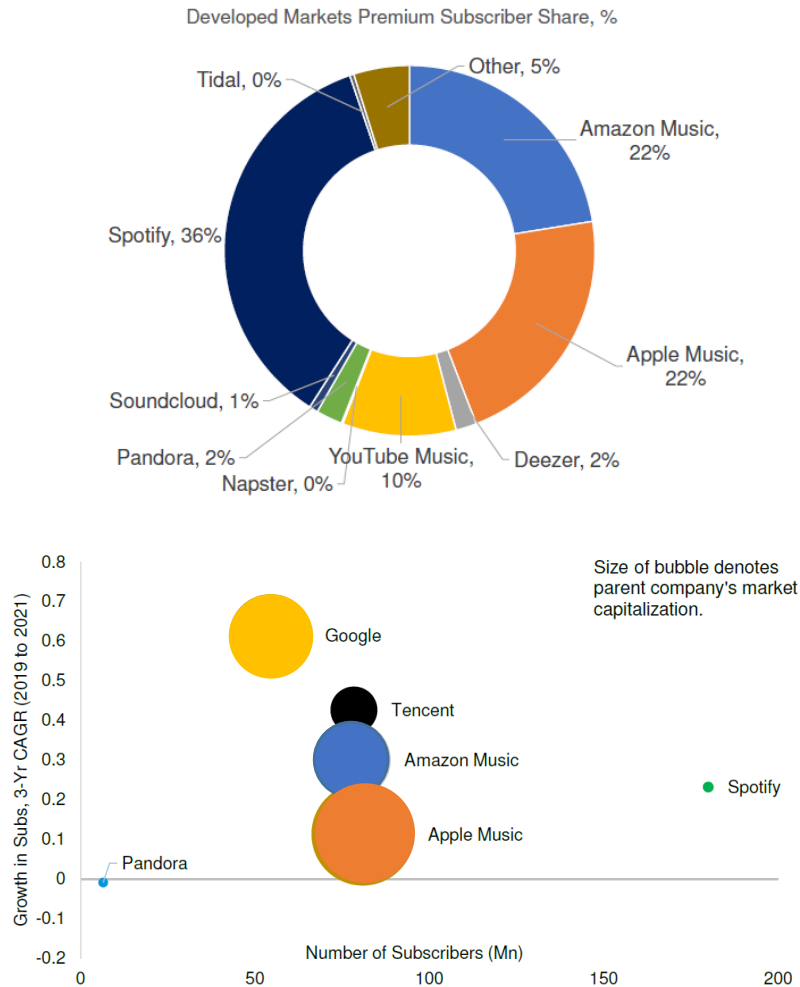
License Moat

Likely?



IS THERE A MOAT?

Competition is fierce and well funded. But, competition is not new, and Spotify lead seems to be getting bigger



Potential Moat

Likely?

Low Cost Producer / Scale Moat

Brand Moat

Network Effect Moat



Evolution and Evidence

- Started with “instant” playback capability
- Innovated to human curated playlists, others followed
- Evolved to AI based curation where scale matters:
 - Spotify has over 3 billion playlists, Apple has 35K
 - Spotify users listened nearly 1.1B hours last year, Apple users streamed about 250M hours
 - Spotify has ~50K songs uploaded per day (15M songs per year). Independent artists & bands now own 30% of overall market share.
- Recommendation engine drives brand affinity, which drives sharing of new playlists and social networking



INVESTORPLACE

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[Home](#) / [Today's Market](#)

CEO Daniel Ek Just Bought \$50 Million of Spotify (SPOT) Stock. Here's Why.

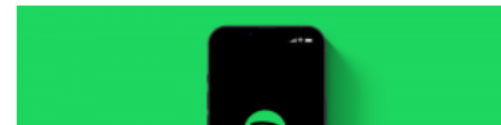
Ek is purchasing SPOT stock for the first time since 2019

By **Eddie Pan**, InvestorPlace Assistant News Writer May 6, 2022, 11:41 am EDT



Shares of **Spotify** (NYSE:**SPOT**) stock are in full focus today after CEO Daniel Ek disclosed a \$50 million insider purchase. This year, SPOT stock has gotten hammered; shares are down over 50% year-to-date (YTD). For comparison, the **S&P 500** is down about 13% YTD.

Last week, the streaming company [reported earnings](#), which caused SPOT stock to close down more than 12%. Spotify posted revenue of 2.66

million (Q4 2021) revenue and



- KMF Catalyst Framework -

Catalysts to Drive Price Towards Intrinsic Value			
Company			
 Spotify®	Grow Sales	Cut Costs	KMF Advice
	Buy Backs	Place Debt	Asset Sales
 Spotify®	Rising Prices	Globalization	Rising Rates
	Operational	Financial	Macro
	✓	✓	✓

- **Operational:** Podcast/Audiobook investments, user growth, ad-monetization, label negotiations
- **Financial:** Investor day pointers to GM expansion, better FCF generation, acquisition
- **Macro:** Global user growth, especially in emerging markets

COMPELLING INVESTMENT

- MOI Investment Checklist -

- Spotify “checks” most MOI investment criteria
 - ✓ Value – stock has declined to no-growth price
 - ✓ Safety – sufficient liquidity and strong cash flow
 - ✓ Moat – brand and potential network/switching moats demonstrated
 - ✓ Management – Ek good record, putting money where mouth is
 - ✓ Capitalization – very strong balance sheet
 - ✓ Performance – shares trading at depressed levels
 - ✓ Macro – may see ad shift
- Spotify shares have substantial upside potential
 - Recently bounced off “no growth” price
 - Historically high reinvestment rates and return on investment when viewed through “stand-still free cash flow” lens
- We look forward to feedback and any questions
 - Reach us at email@kmfinvestments.com

RMD

INVESTMENTS