Cash Investment Management

Spotify's Greatest Hits

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With a subscription revenue model helping to enhance its cash flow forecasting, Spotify is able to manage a diversified investment portfolio through its treasury team and external asset management. Niklas Muhrbeck, Head of Financial Market Activities at Spotify's Treasury spoke in a recent TMI and J.P. Morgan Asset Management webinar about his approach to investment management in a low interest rate environment.

Spotify, the global music streaming service, has been on a rapid growth journey since being founded in 2006 by Daniel Ek and Martin Lorentzon. Just 15 years later, it has 356 million monthly active users and 158 million subscribers. There are close to 80 million tracks on the platform and it is available in 178 markets globally.

Looking at the company's financials, as of 31 December 2020 it had close to €8bn in revenue, while on the balance sheet it had €2.4bn in cash equivalents and €650m in short-term investments, just over €3bn in total. Spotify is incorporated in Luxembourg, which is its listed entity on the New York Stock Exchange. The company also has a subsidiary in Stockholm, Sweden, where it has its headquarters, and a subsidiary in the US.

The company's treasury journey has also been rapid. Spotify hired its first treasury employee in 2013, and by 2015 the company had implemented a software-as-a-service treasury management system (TMS) for treasury purposes as well as operational payments and financial payments. All payments flow through the TMS, providing excellent visibility over its global cash.

"As a company, Spotify is usually cash flow positive, which means that we receive our revenue subscriptions before we pay royalties to our record labels," comments Muhrbeck.

Establishing an investment infrastructure

In 2016, Spotify issued $1bn in convertible debt. With $1bn in cash, a more sophisticated investment infrastructure had to be put in place, and this was also the year when Spotify took its first steps further out the yield curve – with the help of long-term partner, J.P. Morgan Asset Management.

Spotify then went public on the New York Stock Exchange in 2018, through a direct listing as opposed to an initial public offering (IPO). The difference being that with a direct listing, a company puts its shares up for trading without raising any cash, something Spotify did not need to do as it already had funds.

Spotify's investment journey started with a set-up of fixed value government money market funds (MMFs), repo agreements and short-duration separate accounts.

"We knew pretty well how much cash we had to hold in the short term, and we knew the amount that we could invest on a more long-term horizon," says Muhrbeck. "The optimal solution for us with our strategic cash was to open up two separate accounts with two different providers. In the heyday of interest rates and corporate liquidity management, it was less difficult to achieve yield by investing in triple-A to double-A-rated corporates."

On the other hand, in today's environment, in order to generate positive income in euros or even in US dollars, treasurers need to either extend out the yield curve in terms of duration or to add additional credit risk.

"The question I'm always asking is: 'Is credit risk something a corporate treasury should engage in?'" Muhrbeck explains. "In order to do so, you should have the proper infrastructure in place. You need to have expertise in credit analysis, you need to have a large enough treasury and risk operations to manage both, setting out the day-to-day work with the investments and also corporate actions. As we are fewer than 10 people in our treasury team, we have decided to have more strategic cash outsourced, while still having the ultra-short liquidity management in-house."

Applying treasury policy to the fund landscape

One challenge that treasurers face in the investment space is to understand what each investment instrument truly offers. The naming conventions for such funds can differ depending on the jurisdiction and the product, while differences in regulation between US and Europe also have an impact.

"As a first step, I would disregard the name of the fund completely and instead look at the characteristics," notes Muhrbeck. Whether it's a fixed NAV [net asset value], low volatility NAV, or variable NAV, for example, it will give you a hint of what type of fund it is, but you really have to look under the hood in order to see the underlying differences. There are multiple interests in metrics you can look at. What you have to do is find the ones that align with your internal policy and your view on the type of investment."

Treasury policy will set the remit for what is possible for a company's cash investments, from the volume of cash that can be used through to the risk profile that will determine which investment instruments are in scope and which pose too much risk and must be avoided.

"When looking at an investment policy, you involve the board and the audit company, but you also need to bring in accounting," explains Muhrbeck. "They need to determine the accounting treatment, and the accounting treatment of the product can be different depending on the characteristics of the underlying funds. That's definitely something to consider."

Like most companies, Spotify conducts an annual revision of its treasury policy. But Muhrbeck notes that companies also need to be able to make updates to the policy during the year.

He continues: "We can make changes as we see fit, because if a new investment opportunity arises that we want to take advantage of, we may need to make a change. Or it could be that you just want to make the policy more explicit to cater for new investments. That's something you will always need to keep in mind."

Aside from those more pressing changes, it is important for treasury to keep track of all the new additions it wants to include in the policy that we can wait until the annual review, so that these are ready when the policy renewal comes up.

NIKLAS MUHRBECK

Head of Financial Market Activities, Spotify

It is often the case that treasurers have to educate senior management and the board regarding financial products and treasury policy. For a global company such as Spotify, which operates on both sides of the Atlantic, there can be products that are well known in Europe – such as a covered bond– which is less common in the US. An example Muhrbeck cites relates to negative yield. A couple of years ago trying to explain that concept to a manager in the US was a challenge because no one had experience of a negative rate environment.

"One of our last amendments to the policy was on this issue," Muhrbeck recalls. "We wanted to diversify away from financial institutions in our portfolio, so we did an analysis together with our portfolio managers. We looked at not only adding corporate debt at the lower rate into our portfolio but also at how many basis points in yield we could expect to gain without compromising on the risk adjusted return. That's an important concept and that's also the analysis we used in the audit committee to invest in lower-rated corporate debt."

In-house or outsourcing?

When it comes to making cash investments, treasurers choose whether to directly manage the investments themselves or to outsource this work to an asset manager. For Muhrbeck, this decision is based on the objective of the treasury department.

"When it comes to investments, our objective is to preserve capital and maximise returns and deal within the guidelines that we have in our policy," he explains. "When investing in a fund, if it's a fixed net asset value, you're getting your dividend payments, but if you're moving to low volatility, to variable net asset value, when you're coming to the prime category of funds you must be aware of the fact that in addition to dividends you will also have re-evaluation effects. When you decide to take that step, you need to understand the driving forces behind the net asset value. I like to be active and I like to understand the product."

Spotify's treasury manages approximately one-third of its investments in-house. "We do that with a purpose of omitting payment obligations in the near term," explains Muhrbeck. "The duration of these investments is typically 90 days, so that's our operational cash to facilitate for our short-term payments. We can invest in any of the major currencies we have swap capabilities for, if we like."

The greater share of Spotify's investments is outsourced, with MMFs included in the outsourced investments. Given the fact that two-thirds of the portfolio is outsourced, the broader treasury team does not have to be involved in the day-to-day activities and can instead focus on value-adding activities.

"We like to focus on robotic process automation, for example," Muhrbeck says. "That's a way for us to become more efficient and take away the administrative variable. I put a lot of effort and time into foreign exchange, because that's where we can actually have a direct impact on the net revenue."

Spotify has more than one portfolio manager and they are investing according to the same treasury policy and investment mandate. The portfolios have different yields due to the variety of approaches taken by portfolio managers, for example by allocating the portfolio differently between corporate and government bonds. To keep track of these variations, the company uses a benchmark as a comparison and evaluation tool.

"If you decide to use a benchmark as a comparison for your portfolio manager, you must consider that a standard benchmark might not be optimal for your specific portfolio," suggests Muhrbeck. "I would consider some sort of hybrid benchmark as the best solution. A standard benchmark could be, for example, a 50/50 split between corporate and government bonds, but your portfolio might be 80/20. In that situation you need to have a hybrid benchmark in order to make the best evaluation as possible. I like to be involved in this too; the productivity of our portfolio managers is important to me."

Successful diversification

Having a diversified investment portfolio can help shield treasury cash investments from a level of market volatility. It is vital that corporates have an excellent grasp on their cash flow to be able to diversify confidently. At Spotify, which has a subscription-based business model, treasury knows exactly how much money is coming in and when. As all payments globally flow through its TMS, treasury has full visibility over cash outflows and inflows, which is essential for liquidity planning and cash allocation.

"We can optimise exactly how much cash we need in the short term so we can maximise the yield somewhere else," explains Muhrbeck. "We can do this without having to redeem the funds because of an unexpected outflow. That's also good if you're looking into investing into funds with fewer assets under management than some of the large players. If you have a smaller fund, in theory it could be less liquid and more sensitive to large inflows and outflows. Good cash flow forecasting will provide you with confidence to invest a larger share in a smaller fund."

Platforms like J.P. Morgan Asset Management's 'Morgan Money' are also assisting corporates in finding this level of confidence. Such platforms provide the risk analytics and reporting, helping corporates to feel more comfortable 'stepping out'. And with the investment infrastructure that Muhrbeck and his team have been able to set up in partnership with J.P. Morgan Asset Management, together with excellent cash visibility enabled through accurate cash flow forecasting, Spotify's treasury team looks set to chart success for the foreseeable future. ■