

Pandora Media, Inc.
Form 10-Q
May 29, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 30, 2013

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-35198

Pandora Media, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

94-3352630

(I.R.S. Employer
Identification No.)

2101 Webster Street, Suite 1650

Oakland, CA

(Address of principal executive offices)

94612

(Zip Code)

(510) 451-4100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of registrant's common stock outstanding as of May 24, 2013 was: 174,801,815.

Table of Contents

Pandora Media, Inc.

FORM 10-Q Quarterly Report

Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1.</u> <u>Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets as of January 31, 2013 and April 30, 2013 (unaudited)</u>	3
<u>Condensed Consolidated Statements of Operations for the Three Months Ended April 30, 2012 and 2013 (unaudited)</u>	4
<u>Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended April 30, 2012 and 2013 (unaudited)</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended April 30, 2012 and 2013 (unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4.</u> <u>Controls and Procedures</u>	34
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1.</u> <u>Legal Proceedings</u>	35
<u>Item 1A.</u> <u>Risk Factors</u>	35
<u>Item 6.</u> <u>Exhibits</u>	36
<u>Signatures</u>	37

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Pandora Media, Inc.****Condensed Consolidated Balance Sheets****(In thousands, except share and per share amounts)****(Unaudited)**

	As of January 31, 2013	As of April 30, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 65,725	\$ 55,435
Short-term investments	23,247	19,983
Accounts receivable, net of allowances of \$761 and \$472 at January 31 and April 30, 2013, respectively	103,410	105,318
Prepaid expenses and other current assets	6,232	6,198
Total current assets	198,614	186,934
Property and equipment, net	17,758	20,866
Other assets	2,460	2,338
Total assets	\$ 218,832	\$ 210,138
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 4,471	\$ 7,471
Accrued liabilities	7,590	8,371
Accrued royalties	53,083	55,712
Deferred revenue	29,266	37,299
Accrued compensation	21,560	16,284
Total current liabilities	115,970	125,137
Other long-term liabilities	3,873	3,571
Total liabilities	119,843	128,708
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 10,000,000 shares authorized as of January 31 and April 30, 2013, respectively; no shares issued and outstanding as of January 31 and April 30, 2013		
Common stock, \$0.0001 par value: 1,000,000,000 shares authorized as of January 31 and April 30, 2013, respectively; 172,506,051 and 174,466,811 shares issued and outstanding as of January 31 and April 30, 2013, respectively	17	17
Additional paid-in capital	238,552	249,570
Accumulated deficit	(139,574)	(168,161)
Accumulated other comprehensive income (loss)	(6)	4
Total stockholders' equity	98,989	81,430
Total liabilities and stockholders' equity	\$ 218,832	\$ 210,138

Edgar Filing: Pandora Media, Inc. - Form 10-Q

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents**Pandora Media, Inc.****Condensed Consolidated Statements of Operations****(In thousands, except per share amounts)****(Unaudited)**

	Three Months Ended	
	April 30,	
	2012	2013
Revenue:		
Advertising	\$ 70,597	\$ 105,146
Subscription services and other	10,187	20,364
Total revenue	80,784	125,510
Costs and expenses:		
Cost of revenue Content acquisition costs	55,818	82,853
Cost of revenue Other	6,917	9,779
Product development	4,119	7,033
Marketing and sales	23,460	40,083
General and administrative	10,612	14,209
Total costs and expenses	100,926	153,957
Loss from operations	(20,142)	(28,447)
Other income (expense):		
Interest income	32	15
Interest expense	(124)	(143)
Other income (expense), net		1
Loss before provision for income taxes	(20,234)	(28,574)
Income tax benefit (expense)	6	(13)
Net loss	(20,228)	(28,587)
Basic and diluted net loss per share	\$ (0.12)	\$ (0.16)
Weighted-average number of shares used in computing basic per share amounts	165,404	173,579

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents

Pandora Media, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		April 30,	
	2012		2013	
Net loss	\$	(20,228)	\$	(28,587)
Other comprehensive income:				
Change in foreign currency translation adjustment				8
Marketable securities:				
Change in net unrealized losses		3		2
Less: reclassification adjustment for net gains included in net income				
Other comprehensive income		3		10
Total comprehensive loss	\$	(20,225)	\$	(28,577)

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents**Pandora Media, Inc.****Condensed Consolidated Statements of Cash Flows****(In thousands)****(Unaudited)**

	Three Months Ended April 30,	
	2012	2013
Operating Activities		
Net loss	\$ (20,228)	\$ (28,587)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,541	2,132
Loss on disposition of assets	32	
Stock-based compensation	5,500	7,381
Amortization of premium on investments	92	42
Amortization of debt issuance cost and debt discount	66	66
Changes in assets and liabilities:		
Accounts receivable	(3,793)	(1,908)
Prepaid expenses and other assets	(433)	97
Accounts payable and accrued liabilities	1,022	2,927
Accrued royalties	4,314	2,629
Accrued compensation	(2,445)	(5,420)
Deferred revenue	2,509	8,033
Reimbursement of cost of leasehold improvements	1,243	
Net cash used in operating activities	(10,580)	(12,608)
Investing Activities		
Purchases of property and equipment	(1,243)	(4,434)
Purchase of short-term investments	(17,641)	(10,761)
Maturities of short-term investments	28,100	13,980
Net cash provided by (used) in investing activities	9,216	(1,215)
Financing Activities		
Proceeds from issuance of common stock	1,928	3,530
Net cash provided by financing activities	1,928	3,530
Effects of foreign currency translation on cash and cash equivalents		3
Net increase (decrease) in cash and cash equivalents	564	(10,290)
Cash and cash equivalents at beginning of period	44,126	65,725
Cash and cash equivalents at end of period	\$ 44,690	\$ 55,435

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Pandora Media, Inc. (the Company or Pandora) provides an internet radio service in the United States, offering a personalized experience for each of its listeners. The Company has developed a form of radio that uses intrinsic qualities of music to initially create stations that then adapt playlists in real-time based on the individual feedback of each listener.

The Company was incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010.

Basis of Presentation

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP) and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company s management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company s financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the fiscal year ended January 31, 2013.

Certain changes in presentation have been made to conform prior period presentation to current period reporting of the Company s content acquisition costs which are now included as a separate line item component of Cost of Revenue in the Company s Statement of Operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Estimates are used for determining selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, stock-based compensation, fair values of investments, income taxes, and accrued royalties. To the extent there are material differences between these estimates, judgments, or assumptions and actual results, the Company s financial statements could be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by

Edgar Filing: Pandora Media, Inc. - Form 10-Q

U.S. GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result.

Fiscal Year

All references herein to a fiscal year refer to the 12 months ended January 31 of such year, and references to the first, second, third and fourth fiscal quarters refer to the three months ended April 30, July 31, October 31 and January 31, respectively.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

2. Summary of Significant Accounting Policies

There have been no material changes to the Company's significant accounting policies as compared to those described in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2013.

Concentration of Credit Risk

For the three months ended April 30, 2012 and 2013, the Company had no customers that accounted for more than 10% of the Company's total revenue.

As of January 31 and April 30, 2013, the Company had no customers that accounted for more than 10% of the Company's total accounts receivable.

Recently Issued Accounting Standards

In February 2013, the FASB issued an update to the reporting of reclassifications out of accumulated other comprehensive income. The guidance requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety from accumulated other comprehensive income to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. In the three months ending April 30, 2013, the Company adopted this guidance, which is related to disclosure only. The Company had no reclassifications out of accumulated other comprehensive income as of April 30, 2013.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****3. Composition of Certain Financial Statement Captions****Cash, Cash Equivalents and Short-term Investments**

Cash, cash equivalents and short-term investments consisted of the following:

	As of January 31, 2013		As of April 30, 2013
	(in thousands)		
Cash and cash equivalents:			
Cash	\$ 22,703	\$	19,104
Money market funds	32,522		28,080
Commercial paper	10,500		7,500
Corporate debt securities			751
Total cash and cash equivalents	\$ 65,725	\$	55,435
Short-term investments:			
Commercial paper	\$ 13,592	\$	14,345
Corporate debt securities	9,655		5,638
Total short-term investments	\$ 23,247	\$	19,983
Cash, cash equivalents and short-term investments	\$ 88,972	\$	75,418

The Company's short-term investments have maturities of less than 12 months and are classified as available for sale. As of January 31 and April 30, 2013 the cost basis of the Company's cash and cash equivalents approximated their fair values and as a result, no unrealized gains or losses were recorded as of January 31 and April 30, 2013.

The following tables summarize the Company's available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of January 31 and April 30, 2013 (in thousands).

	Adjusted Cost		As of January 31, 2013			Fair Value
		\$	Unrealized Gains	Unrealized Losses	\$	
Money market funds	\$ 32,522	\$			\$	32,522
Commercial paper	24,093			(1)		24,092

Edgar Filing: Pandora Media, Inc. - Form 10-Q

Corporate debt securities	9,657	(2)	9,655
Total cash equivalents and marketable securities	\$ 66,272	\$ (3)	\$ 66,269

	As of April 30, 2013			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	\$ 28,080	\$	\$	\$ 28,080
Commercial paper	21,845			21,845
Corporate debt securities	6,390		(1)	6,389
Total cash equivalents and marketable securities	\$ 56,315	\$	\$ (1)	\$ 56,314

The Company's investment policy requires investments to be investment grade, primarily rated A1 by Standard & Poor's or P1 by Moody's or better for short-term investments, with the objective of minimizing the potential risk of principal loss. In addition, the investment policy limits the amount of credit exposure to any one issuer.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

The unrealized losses on the Company's available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of April 30, 2013, the Company owned four securities that were in an unrealized loss position. The Company does not intend nor expect to need to sell these securities before recovering the associated unrealized losses. It expects to recover the full carrying value of these securities. As a result, no portion of the unrealized losses at April 30, 2013 is deemed to be other-than-temporary and the unrealized losses are not deemed to be credit losses. No available-for-sale securities have been in an unrealized loss position for 12 months or more. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's amortized cost basis. During the three months ended April 30, 2013, the Company did not recognize any impairment charges.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

4. Fair Value

The Company records cash equivalents and short-term investments at fair value.

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. Fair value measurements are required to be disclosed by level within the following fair value hierarchy:

Level 1 Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level 3 Inputs lack observable market data to corroborate management's estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. As of January 31 and April 30, 2013 the Company did not hold any Level 3 assets.

When determining fair value, whenever possible the Company uses observable market data, and relies on unobservable inputs only when observable market data is not available.

The fair value of these financial assets and liabilities was determined using the following inputs at January 31 and April 30, 2013:

Quoted Prices in Active Markets for Identical Instruments	Fair Value Measurement Using Significant Other Observable Inputs	Total
--	---	--------------

Edgar Filing: Pandora Media, Inc. - Form 10-Q

	(Level 1)	(Level 2)	(in thousands)
Fair values as of January 31, 2013			
Assets:			
Money market funds	\$ 32,522	\$	\$ 32,522
Commercial paper		24,092	24,092
Corporate debt securities		9,655	9,655
Total assets measured at fair value	\$ 32,522	\$ 33,747	\$ 66,269
Fair values as of April 30, 2013			
Assets:			
Money market funds	\$ 28,080	\$	\$ 28,080
Commercial paper		21,845	21,845
Corporate debt securities		6,389	6,389
Total assets measured at fair value	\$ 28,080	\$ 28,234	\$ 56,314

The Company's money market funds are classified as Level 1 within the fair value hierarchy because they are valued primarily using quoted market prices. The Company's other cash equivalents and short-term investments are classified as Level 2 within the fair value hierarchy because they are valued using professional pricing sources for identical or comparable instruments, rather than direct observations of quoted prices in active markets.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

5. Commitments and Contingencies

Legal Proceedings

Pandora has been in the past, and continues to be, a party to privacy and patent infringement litigation which has consumed, and may continue to consume, financial and managerial resources. The Company is also from time to time subject to various other legal proceedings and claims arising in the ordinary course of its business. The Company records a liability when it believes that it is both probable that a loss has been incurred and the amount can be reasonably estimated. Company management periodically evaluates developments that could affect the amount, if any, of liability that it has previously accrued and makes adjustments as appropriate. Determining both the likelihood and the estimated amount of a loss requires significant judgment, and management's judgment may be incorrect. The Company does not believe the ultimate resolution of any pending legal matters is likely to have a material adverse effect on its business, financial position, results of operations or cash flows.

In June 2011, a putative class action lawsuit was filed against Pandora in the United States District Court for the Northern District of California alleging that it unlawfully accessed and transmitted personally identifiable information of the plaintiffs in connection with their use of the Company's Android mobile application. In addition to civil liability, the amended complaint includes allegations of violations of statutes under which criminal penalties could be imposed if the Company were found liable. Pandora's motion to dismiss the first amended complaint was granted on March 26, 2013. The court allowed the plaintiff to amend his complaint. The amended complaint, filed May 9, 2013, contains allegations similar to those contained in the previous complaint.

In September 2011, a putative class action lawsuit was filed against Pandora in the United States District Court for the Northern District of California alleging that it violated Michigan's video rental privacy law and consumer protection statute by allowing Pandora listeners' listening history to be visible to the public. Pandora's motion to dismiss the complaint was granted on September 28, 2012, judgment was entered on November 14, 2012 and the plaintiff filed a notice of appeal on December 14, 2012.

In April 2011, Augme Technologies, Inc. filed a complaint in the United States District Court for the District of Delaware against Pandora alleging patent infringement. The complaint sought injunctive relief and monetary damages. The parties negotiated a full and final settlement and the case was dismissed on March 15, 2013.

On September 10, 2012, B.E. Technology, LLC filed suit against Pandora in the United States District Court for the Western District of Tennessee alleging that Pandora infringes a B.E. Technology patent and seeking injunctive relief and monetary damages. Pandora filed its answer on December 31, 2012. The court has stayed the action pending its decision on the Company's pending motion to transfer the action to the United States District Court for the Northern District of California.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

On November 16, 2012, 1st Technology, LLC filed suit against Pandora in the United States District Court for the Northern District of Illinois alleging that Pandora infringes three 1st Technology patents and seeking injunctive relief and monetary damages. The court stayed the action pending resolution of Pandora's motion to transfer the action to the Northern District of California.

On January 15, 2012, Unified Messaging Solutions, LLC filed suit against Pandora in the U.S. District Court for the District of Delaware alleging that Pandora infringes four UMS patents and seeking injunctive relief and monetary damages. Pandora filed its answer and counterclaims on March 29, 2013. On April 11, 2013 the case was ordered joined with numerous additional cases that are combined in a multidistrict litigation proceeding pending in the U.S. District Court for the Northern District of Illinois.

On February 26, 2013, Macrosolve, Inc. filed suit against Pandora in the U.S. District Court for the Eastern District of Texas alleging that Pandora infringes a Macrosolve, Inc. patent and seeks injunctive relief and monetary damages. Pandora's answer and counterclaims were filed on April 22, 2013.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

The Company currently believes that it has substantial and meritorious defenses to the claims in the lawsuits discussed above and intends to vigorously defend its position.

The outcome of any litigation is inherently uncertain. Based on the Company's current knowledge it believes that the final outcome of the matters discussed above will not likely, individually or in the aggregate, have a material adverse effect on its business, financial position, results of operations or cash flows; however, in light of the uncertainties involved in such matters, there can be no assurance that the outcome of each case or the costs of litigation, regardless of outcome, will not have a material adverse effect on the Company's business.

Indemnification Agreements, Guarantees and Contingencies

In the ordinary course of business, the Company is party to certain contractual agreements under which it may provide indemnifications of varying scope, terms and duration to customers, vendors, lessors, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of such agreements, services to be provided by the Company or from intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with directors and certain officers and employees that will require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers or employees. Such indemnification provisions are accounted for in accordance with guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others. To date, the Company has not incurred, does not anticipate incurring and therefore has not accrued for, any costs related to such indemnification provisions.

While the outcome of these matters cannot be predicted with certainty, the Company does not believe that the outcome of any claims under indemnification arrangements will have a material adverse effect on the Company's financial position, results of operations, or cash flows.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

6. Accumulated Other Comprehensive Income (Loss)

	Foreign Currency Translation Adjustments		Unrealized losses on Marketable Securities		Total
				(in thousands)	
Balance as of January 31, 2013	\$	(3)	\$	(3)	\$ (6)
Other comprehensive income before reclassifications		8		2	10
Losses (gains) reclassified from accumulated other comprehensive income to net income					
Net change in other comprehensive income		8		2	10
Balance as of April 30, 2013	\$	5	\$	(1)	\$ 4

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

7. Income Taxes

The income tax provision increased by \$19,000 for the three months ended April 30, 2013 compared to the prior year period as a result of changes in states tax rules and additional international tax expense. The effective tax rate for the three months ended April 30, 2013 was less than one percent based on the estimated tax loss for the fiscal year.

There were no material changes to the unrecognized tax benefits in the three months ended April 30, 2013 and the Company does not expect significant changes to unrecognized tax benefits through the end of the fiscal year. Because of the Company's history of tax losses, all years remain open to tax audit.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

8. Debt Instruments

On May 13, 2011, the Company entered into a \$30 million credit facility with a syndicate of financial institutions. The amount of borrowings available under the credit facility at any time is based on the Company's monthly accounts receivable balance at such time, and the amounts borrowed are collateralized by the Company's personal property (including such accounts receivable but excluding intellectual property). Under the credit facility, the Company can request up to \$5 million in letters of credit be issued by the financial institutions.

The credit facility contains customary events of default, conditions to borrowing and covenants, including restrictions on the Company's ability to dispose of assets, make acquisitions, incur debt, incur liens and make distributions to stockholders. The credit facility also includes a financial covenant requiring the maintenance of minimum liquidity of at least \$5 million. During the continuance of an event of a default, the lenders may accelerate amounts outstanding, terminate the credit facility and foreclose on all collateral.

As of April 30, 2013, the Company had \$828,000 in letters of credit outstanding and had \$29.17 million of available borrowing capacity under the credit facility. On December 30, 2011, the Company entered into a cash collateral agreement in connection with the issuance of letters of credit which were used to satisfy deposit requirements under facility leases. As of April 30, 2013, the \$828,000 cash collateral was considered to be restricted cash. The amount is included in other assets on the Company's balance sheet.

Total debt issuance costs associated with the credit facility were \$1.0 million, which are being amortized as interest expense over the four-year term of the credit facility agreement. For the three months ended April 30, 2013, \$0.1 million of debt issuance costs were amortized and included in interest expense.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****9. Stock-based Compensation Plans and Awards**

The Company's 2011 Equity Incentive Plan (the "2011 Plan") provides for the issuance of stock options, restricted stock units and other stock-based awards. Each fiscal year, (beginning with the fiscal year that commenced February 1, 2012 and ending with the fiscal year commencing February 1, 2021), the number of shares in the reserve under the 2011 Plan may be increased by the lesser of (x) 10,000,000 shares, (y) 4.0% of the outstanding shares of common stock on the last day of the prior fiscal year or (z) another amount determined by the Company's board of directors. The share reserve for the fiscal year beginning February 1, 2013 was increased in fiscal 2013 by 3% of the outstanding shares of common stock as of January 31, 2013. The 2011 Plan is scheduled to terminate in 2021, unless the board of directors determines otherwise. The 2011 Plan is administered by the compensation committee of the board of directors of the Company.

Valuation of Awards

The per-share fair value of each stock option was determined on the date of grant using the Black-Scholes option pricing model using the following assumptions:

	Three Months Ended April 30,	
	2012	2013
Expected life (in years)	6.67	6.29
Risk-free interest rate	1.52%	1.18%
Expected volatility	57%	58%
Expected dividend yield	0%	0%

Stock Options

A summary of stock option activity for the three months ended April 30, 2013 is as follows:

Options Outstanding Stock Options	Weighted- Average Exercise Price	Aggregate(1) Intrinsic Value
(in thousands, except share and per share data)		

Edgar Filing: Pandora Media, Inc. - Form 10-Q

Balance as of January 31, 2013	26,102,949	\$	3.22	\$	224,736
Granted	1,365,000		11.49		
Exercised	(1,573,269)		2.24		
Cancelled	(210,962)		7.82		
Balance as of April 30, 2013	25,683,718	\$	3.68	\$	266,196
Equity awards available for grant at April 30, 2013	12,812,657				

(1) Amounts represent the difference between the exercise price and the fair value of common stock at period end for all in the money options outstanding based on the fair value per share of common stock.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued***Restricted Stock Units*

The fair value of the restricted stock units (RSUs) is expensed ratably over the vesting period. RSUs vest annually on a cliff basis over the service period, generally four years.

During the three months ended April 30, 2013, the Company recorded stock-based compensation expense related to RSUs of approximately \$5.8 million. As of April 30, 2013, total compensation cost not yet recognized of approximately \$93.7 million related to non-vested RSUs, is expected to be recognized over a weighted average period of 3.31 years.

The following table summarizes the activities for our RSUs for the three months ended April 30, 2013:

	Number of Shares	Weighted- Average Grant-Date Fair Value
Unvested at January 31, 2013	5,511,709	\$ 10.57
Granted	3,958,634	12.46
Vested	(387,490)	11.72
Canceled	(134,015)	11.21
Unvested at April 30, 2013	8,948,838	\$ 11.35

Stock Option Awards with Both a Service Period and a Market Condition

On March 22, 2012, Mr. Joseph Kennedy, the Company's Chief Executive Officer, was granted a non-statutory stock option to purchase 800,000 shares of common stock. This option grant to Mr. Kennedy was intended to be in lieu of an annual equity grant for fiscal 2014. This option includes both a service period and a market vesting condition. The stock option will vest if the 60-day trailing volume weighted average price of the Company's common stock exceeds \$21.00 per share, or if there is a sale of the Company for at least \$21.00 per share, in each case prior to July 6, 2017. If the market condition is met, the performance option will vest ratably over four years, beginning on July 6, 2013, subject to severance and change of control acceleration. To the extent that the market condition is not met, the option will not vest and will be cancelled. The Company used a binomial model to value the option with a market condition. The Company used Monte Carlo simulation techniques that incorporate assumptions as provided by management for the term of option from grant date (in years), risk-free interest rate, stock price volatility and beginning stock price. The Company does not adjust compensation cost recognition for subsequent changes in the expected outcome of the market-vesting conditions.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

The following assumptions were used to value the grant using the Monte-Carlo simulation option pricing model: 10-year term, risk-free interest rate of 2.33%, expected volatility of 70% and a beginning stock price of \$10.63. The grant-date fair value for the option was \$6.08 per share.

On March 7, 2013, the Company announced that it will begin a process to identify a successor to Mr. Kennedy who will continue in his current role until his successor is named. As a result, the Company re-evaluated certain estimates and assumptions related to the stock-based compensation expense associated with his awards and reduced current period stock-based compensation expense by \$1.4 million related to the award with both a service period and a market condition and \$0.3 million related to awards without a market condition.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued*****Stock-based Compensation Expenses***

The weighted-average fair value of stock option grants was \$6.02 and \$6.31 for the three months ended April 30, 2012 and 2013, respectively. As of April 30, 2013, total compensation cost related to stock options granted, but not yet recognized, was approximately \$29.7 million which the Company expects to recognize over a weighted-average period of approximately 2.4 years.

The total grant date fair value of stock options vested during the three months ended April 30, 2012 and 2013 was \$3.4 million and \$2.2 million, respectively. The aggregate intrinsic value of all options and exercised during the three months ended April 30, 2012 and 2013 was \$32.4 million and \$17.7 million, respectively.

Stock-based compensation expenses related to all employee and non-employee stock-based awards was as follows (in thousands):

	Three Months Ended	
	April 30,	
	2012	2013
	(unaudited)	
Stock-based compensation expenses:		
Cost of revenue - Other	\$ 263	\$ 456
Product development	986	1,763
Marketing and sales	2,930	4,848
General and administrative	1,321	314
Total stock-based compensation, recorded in costs and expenses	\$ 5,500	\$ 7,381

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****10. Net Loss Per Share**

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period.

Diluted net loss per share is computed by giving effect to all potential shares of common stock, including stock options and restricted stock units to the extent dilutive. Basic and diluted net loss per share was the same for the three months ended April 30, 2012 and 2013 as the inclusion of all potential common shares outstanding would have been anti-dilutive.

The following table sets forth the computation of historical basic and diluted net loss per share (in thousands except per share amounts):

	Three Months Ended	
	2012	2013
	April 30,	
Numerator		
Net loss	\$ (20,228)	\$ (28,587)
Denominator		
Weighted-average common shares outstanding used in computing basic and diluted net income (loss) per share	165,404	173,579
Net loss per share, basic	\$ (0.12)	\$ (0.16)

The following potential common shares outstanding were excluded from the computation of diluted net loss per share because including them would have been anti-dilutive (in thousands):

	Three Months Ended	
	April 30, 2012	April 30, 2013
Options to purchase common stock	33,228	25,683
Restricted stock units	3,335	8,949
Total common stock equivalents	36,563	34,632

Table of Contents

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with the condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended January 31, 2013 filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act). All references herein to a fiscal year refer to the 12 months ended January 31 of such year, and references to the first, second, third and fourth fiscal quarters refer to the three months ended April 30, July 31, October 31 and January 31, respectively.

This Quarterly Report on Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Exchange Act, including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses and plans and objectives of management. In some cases, you can identify forward-looking statements by terms such as anticipate, believe, estimate, expect, intend, may, might, plan, project, will, would, should, could, can, predict, potential, continue, objective, or the negative of these terms, and similar expressions intended to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and involve known risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievement to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors included in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended January 31, 2013. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements. We qualify all of our forward-looking statements by these cautionary statements. These and other factors could cause our results to differ materially from those expressed in this Quarterly Report on Form 10-Q.

Some of the industry and market data contained in this Quarterly Report on Form 10-Q are based on independent industry publications, including those generated by Triton Digital Media or (Triton) or other publicly available information. This information involves a number of assumptions and limitations. Although we believe that each source is reliable as of its respective date, we have not independently verified the accuracy or completeness of this information.

As used herein, Pandora, the Company, we, our, and similar terms refer to Pandora Media, Inc., unless the context indicates otherwise.

Pandora and other trademarks of ours appearing in this report are our property. This report may contain additional trade names and trademarks of other companies. We do not intend our use or display of other companies' trade names or trademarks to imply an endorsement or sponsorship of us by such companies, or any relationship with any of these companies.

Overview

Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners. We have pioneered a new form of radio one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. As of April 30, 2013, we had approximately 200 million registered users, which we define as the total number of accounts that have been created for our service at period end. As of April 30, 2013 more than 150 million registered users have accessed Pandora through smartphones and tablets. For the three months ended April 30, 2013, we streamed 4.18 billion hours of radio and as of April 30, 2013, we had 70.1 million active users during the prior 30 day period. According to a December 2012 report by Triton, we have more than a 70% share of internet radio among the top 20 stations and networks in the United States. Since we launched our free, advertising-supported radio service in 2005 our listeners have created over 4.6 billion stations.

Since we started the Music Genome Project in 2000, we have continuously built our song catalog, refined the genotyping model and developed proprietary algorithms for building personalized playlists for our listeners based both on our analysis and feedback data from our listeners.

Our comedy service leverages similar technology to the technology underlying the Music Genome Project, allowing a listener to choose a favorite comedian or a genre as a seed to start a station and then give feedback to personalize that station.

Table of Contents

One key element of our strategy is to make the Pandora service available everywhere that there is internet connectivity. To this end, we make the Pandora service available through a variety of distribution channels. In addition to streaming our service to traditional computers, we have developed Pandora mobile device applications or apps for smartphones such as Android, Blackberry and the iPhone, and for tablets including the iPad, Android tablets, and Amazon Kindle Fire tablets. We distribute those mobile apps free to listeners via app stores. Pandora is now available on more than 1,000 integrations, including automobiles, automotive aftermarket devices and consumer electronic devices. In the consumer electronics space, more than 760 consumer electronics devices from third-party distribution partners such as Samsung, Roku and DirecTV make Pandora available in the home. Many automotive partners, including Alpine Electronics, Audiovox, Clarion, Dual Electronics, JVC, Kenwood, Pioneer and Sony, incorporate our application into aftermarket radios. We have also developed relationships with major automobile manufacturers; vehicle models have been made available by Acura, BMW, Buick, Cadillac, Chevrolet, Ford, GMC, Honda, Hyundai, Lexus, Lincoln, Mazda, Mercedes-Benz, MINI, Nissan, Scion, Suzuki and Toyota. Additionally, Dodge, Infiniti, Jeep, Kia and Ram have publicly announced their plans to offer Pandora integration on future vehicles. Holden Ltd., a subsidiary of General Motors, has also launched the first in-car system in Australia to offer full compatibility with Pandora. Under the arrangements, we receive no financial compensation and recognize no revenue from these automotive distribution partners.

In June 2012, we entered into or activated agreements which allow Pandora to launch in New Zealand, Australia and the territories associated with the two countries. The arrangements with PPNZ Music Licensing Limited, which represents recording artists and record companies, and APRA/AMCOS, which represents songwriters, composers and publishers, have not had a material effect on our results of operations to date.

Business Model

We derive the substantial majority of our revenue from the sale of display, audio and video advertising for delivery across our traditional computer-based, mobile and other connected device platforms. We also offer a paid subscription service to listeners, which we call Pandora One. While historically our revenue growth was principally attributable to selling display advertising through our traditional computer-based platform, we now generate a majority of our revenue from mobile and other connected devices and our advertising includes a mix of audio, display and video. This expansion of our services also presents an opportunity for us to reach our audience anytime, anywhere they enjoy music, and therefore offer additional distribution channels to current and potential advertisers for delivery of their advertising messages.

Growth in our active users and distribution platforms has fueled a corresponding growth in listener hours. Our total number of listener hours is a key driver for both revenue generation opportunities and content acquisition costs, which are the largest component of our operating expenses:

- *Revenue.* Listener hours define the number of opportunities we have to sell advertisements, which we refer to as inventory. Our ability to attract advertisers depends in large part on our ability to offer sufficient inventory within desired demographics. In turn, our ability to generate revenue depends on the extent to which we are able to sell the inventory we have.
- *Cost of Revenue Content Acquisition Costs.* The number of sound recordings we transmit to users of the Pandora service, as generally reflected by listener hours, drives substantially all of our content acquisition costs, although certain of our licensing agreements require us to pay fees for public performances based on a percentage of revenue.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

We pay royalties to the copyright owners (or their agents) of each sound recording that we stream and to the copyright owner (or their agents) of the musical work that underlies that sound recording, subject to certain exclusions. We record these royalties as content acquisition costs. Under U.S. law, we are granted the right to stream any lawfully released sound recordings, subject to compliance with certain statutory and regulatory requirements. Royalties for sound recordings are negotiated with and paid to record labels or to SoundExchange, a performance rights organization (PRO) authorized to collect royalties on behalf of all sound recording copyright owners. Royalties for musical works are negotiated with and paid to publishing companies such as Sony ATV and Entertainment World Inc. or EMI; or PROs such as the American Society of Composers, Authors and Publishers, or ASCAP; Broadcast Music, Inc., or BMI; and SESAC Inc. or SESAC. Royalties are calculated based on sound recordings streamed, revenue earned or other usage measures. If we cannot agree on royalty rates, the dispute will be resolved by the Copyright Royalty Board, or CRB, in the case of SoundExchange, and by the rate court in the U.S. District Court for the Southern District of New York in the case of ASCAP and BMI. In November 2012, we filed a petition in rate court to request a determination of reasonable fees and terms with ASCAP. In May 2011, we started streaming spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any PRO for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization. However, we pay royalties to SoundExchange at federally negotiated rates for the right to stream this spoken word comedy content.

Table of Contents

Given the royalty structures in effect with respect to the public performance of sound recordings in the United States, our content acquisition costs increase with each additional listener hour, regardless of whether we are able to generate more revenue. As such, our ability to achieve and sustain profitability and operating leverage depends on our ability to increase our revenue per hour of streaming through increased advertising sales across all of our delivery platforms.

As our mobile listenership increases, we face new challenges in optimizing our advertising products for delivery on mobile and other connected device platforms and monetizing inventory generated by listeners using these platforms. The mobile digital advertising market is at an early stage of development, with lower overall spending levels than traditional online advertising markets, and faces technical challenges due to fragmented platforms and lack of standard audience measurement protocols.

In addition, our strategy includes increasing the number of ad campaigns for traditional computer, mobile and other connected device platforms sold to local advertisers, placing us in more direct competition with broadcast radio for advertiser spending, especially for audio advertisements. By contrast, historically our display advertisers have been predominantly national brands. To successfully monetize our growing listener hours, we may have to convince a substantial base of local advertisers of the benefits of advertising on the Pandora service including demonstrating the effectiveness and relevance of our advertising products, and in particular, audio advertising products, across the range of our delivery platforms.

Starting in March 2013, we instituted a 40 hour per month listening limit for our advertising supported service on certain mobile and other connected devices. Listeners who reach this limit may continue to use our ad supported service on these devices by paying \$0.99 for the remainder of the month, may listen to our ad supported service on their desktop or laptop computers, or may purchase annual or monthly Pandora One subscriptions for \$36 per year or approximately \$4 per month, respectively.

Our total revenue has grown from \$80.8 million in the three months ended April 30, 2012 to \$125.5 million in the three months ended April 30, 2013. At the same time, our total costs and expenses have grown from \$100.9 million in the three months ended April 30, 2012 to \$154.0 million in the three months ended April 30, 2013, principally as a result of the growth in content acquisition costs. As the volume of music we stream to listeners in the United States increases, our content acquisition costs will also increase, regardless of whether we are able to generate more revenue. In addition, we expect to invest heavily in our operations to support anticipated future growth. One of our key objectives is furthering our market leadership in internet radio, which we believe will strengthen our brand and help us to convince advertisers to allocate spending towards our ad products. As such, a central focus is adding, retaining and engaging listeners to build market share and grow our listener hours. For the foreseeable future, we expect that there will be periods during which our ability to monetize listener hours will lag the growth of listener hours. As our business matures, we expect that the growth rate in our listener hours will decline relative to our increased ability to monetize listener hours. However, we expect to incur annual losses on a U.S. GAAP basis in the near term.

Key Metrics:

The tables below set forth our listener hours for the three months ended April 30, 2012 and 2013 and our active users as of January 31, 2013 and April 30, 2013, along with our total, traditional computer and mobile and other connected devices ad RPMs and LPMs for the three months ended April 30, 2012 and 2013.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

	Three Months Ended April 30,	
	2012	2013
Listener hours (in billions)	3.09	4.18

	As of January 31, 2013	As of April 30, 2013
Active users (end of period, in millions)	65.6	70.1

Advertising revenue per thousand listener hours

	Three Months Ended April 30,	
	2012	2013
Total	\$ 24.82	\$ 28.02
Traditional computer	46.52	48.16
Mobile and other connected devices	17.88	23.23

Licensing costs per thousand listener hours

	Three Months Ended April 30,	
	2012	2013
LPMs	\$ 18.03	\$ 19.81

Table of Contents

Active Users. Active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts. We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time, which is particularly important to potential advertisers.

Listener Hours. We track listener hours because it is a key indicator of the growth of our business. We calculate listener hours based on the total bytes served for each track that is requested and served from our servers, as measured by our internal analytics systems, whether or not a listener listens to the entire track. We believe this server-based approach is the best methodology to forecast advertising inventory given that advertisements are frequently served in between tracks and are often served upon triggers such as a listener clicking thumbs-down or choosing to skip a track. To the extent that third-party measurements of listener hours are not calculated using a similar server-based approach, the third-party measurements may differ from our measurements.

Ad RPMs. We track advertising revenue per thousand listener hours for our free, advertising supported service (ad RPMs) because it is a key indicator of our ability to monetize advertising inventory created by our listener hours. We focus on total ad RPMs across all of our delivery platforms. RPMs compare advertising revenue generated in a given period to advertising supported listener hours in the period and we believe such total ad RPMs to be the central top-line indicator for evaluating the results of our monetization efforts. We calculate total ad RPMs by dividing advertising revenue we generate by the number of thousands of listener hours of our advertising-based service.

Total RPMs. We also provide estimates of disaggregated total and ad RPMs for our traditional computer platform as well as our mobile and other connected devices platforms, which we calculate by dividing the estimated advertising revenue generated through the respective platforms by the number of thousands of listener hours of our advertising-based service delivered through such platforms. While we believe that such disaggregated RPMs provide directional insight for evaluating our efforts to monetize our service by platform, we do not validate disaggregated RPMs to the level of financial statement reporting. Such metrics should be seen as indicative only and as management's best estimate. We continue to refine our systems and methodologies used to categorize RPMs across our delivery platforms. Period-to-period results should not be regarded as precise nor can they be relied upon as indicative of results for future periods. In addition, as our business matures and in response to technological evolutions, we anticipate that the relevant indicators we monitor for evaluating our business may change.

LPMs. We track licensing costs per thousand listener hours (LPMs) and analyze them in combination with our analysis of RPMs as they provide a key indicator of our profitability. LPMs are relatively fixed licensing costs with scheduled annual rate increases which drive period over period changes in LPMs. The margin on our business improves with growth in ad RPMs and subscription RPMs.

Table of Contents

Total ad RPMs. Three months ended April 30, 2012 and 2013. Total ad RPMs increased compared to the respective prior year period due to advertising sales growth outpacing the growth in advertising listener hours in part due to the effect of the listening limit on mobile and other connected devices.

Traditional computer ad RPMs. Three months ended April 30, 2012 and 2013. Traditional computer ad RPMs increased compared to the respective prior year period, primarily due to traditional computer revenue growing at a faster pace than listening hours on that platform primarily due to an increase in the number of ads sold.

Mobile and other connected device ad RPMs. Three months ended April 30, 2012 and 2013. Mobile and other connected device ad RPMs increased compared to the respective prior year periods primarily due to mobile and connected device revenue growing at a faster pace than listening hours due in part to the effect of the listening limit on certain mobile and other connected devices.

Specific to the revenue component of the RPM ratio, total advertising revenue increased by approximately 49% during the three months ended April 30, 2013 compared to the prior year period, with advertising revenue on mobile and other connected devices increasing approximately 83% and advertising revenue on traditional computers increasing by approximately 8%.

Total RPMs for the three months ended April 30, 2012 and 2013 were \$26.09 and \$30.01, respectively. Within this, mobile and other connected device total RPMs for the three months ended April 30, 2012 and 2013, were \$18.86 and \$25.31 respectively. Traditional computer RPMs for the three months ended April 30, 2012 and 2013 were \$45.54 and \$48.04, respectively. These changes were driven by the same factors mentioned above within the discussion of ad RPMs.

Basis of Presentation

Revenue

Advertising Revenue. We generate advertising revenue primarily from display, audio and video advertising, which is typically sold on a cost-per-thousand impressions, or CPM, basis. Advertising campaigns typically range from 1 to 12 months, and advertisers generally pay us based on a minimum number of delivered impressions or the satisfaction of other criteria, such as click-throughs. We may earn referral revenue when, for example, a listener clicks on an advertisement and signs up for membership with an advertiser. We also have arrangements with advertising agencies and brokers pursuant to which we provide the ability to sell advertising inventory on our service directly to advertisers. We report revenue under these arrangements net of amounts due to agencies and brokers. For the three months ended April 30, 2012 and 2013, advertising revenue accounted for 87% and 84% of our total revenue, respectively, and we expect that advertising will comprise a substantial majority of revenue for the foreseeable future. Advertising revenue decreased as a percentage of total revenue due to higher subscription sales partially driven by the implementation of the mobile listening limit.

Subscription Services and Other Revenue. Subscription revenue is generated through the sale of a premium version of the Pandora service which currently includes advertisement-free access and higher audio quality on the devices that support it. Subscription revenue derived from

Edgar Filing: Pandora Media, Inc. - Form 10-Q

direct sales to listeners is recognized on a straight-line basis over the duration of the subscription period. Subscription revenue derived from sales through some mobile operating systems may be subject to refund or cancellation terms which may affect the timing or amount of the subscription revenue recognition. When refund rights exist, we recognize revenue when services have been provided and the rights lapse or when we have developed sufficient transaction history to estimate a reserve. As of April 30, 2013, we had deferred all revenue subject to refund rights totaling approximately \$8.1 million, as we do not currently have sufficient history to estimate a reserve. For the three months ended April 30, 2012 and 2013, subscription services and other revenue accounted for 13% and 16% of our total revenue, respectively. Subscription services revenue increased as a percentage of total revenue due to higher subscription sales partially driven by the implementation of the mobile listening limit.

Deferred Revenue. Our deferred revenue consists principally of both prepaid but unrecognized subscription revenue and advertising fees received or billed in advance of the delivery or completion of the delivery of services. Deferred revenue is recognized as revenue when the services are provided and all other revenue recognition criteria have been met.

Costs and Expenses

Costs and expenses consist of cost of revenue - content acquisition costs, cost of revenue - other, product development, marketing and sales and general and administrative expenses. Cost of revenue - content acquisition costs are the most significant component of our costs and expenses followed by employee-related costs, which includes stock-based compensation expenses. We

Table of Contents

expect to continue to hire additional employees in order to support our anticipated growth and our product development initiatives. In any particular period, the timing of additional hires could materially affect our operating expenses, both in absolute dollars and as a percentage of revenue. We anticipate that our costs and expenses will increase in the future.

Cost of revenue Content Acquisition Costs. Content acquisition costs principally consist of royalties paid for streaming music or other content to our listeners. Royalties are calculated using negotiated rates documented in master royalty agreements and are based on both percentage of revenue and listening metrics. For example in the three months ended April 30, 2012 and 2013, under some royalty arrangements we paid a fee per track, while in other cases we paid royalties based on a percentage of our revenue. In still other cases we pay royalties based on a combination of these metrics.

We periodically test our royalty calculation methods to ensure we are accurately reporting and paying royalties. The performance rights organizations have the right to audit our playlist and payment records, and any such audit could result in disputes over whether we have paid the proper royalties. If such a dispute were to occur, we could be required to pay additional royalties and the amounts involved could be material.

For royalty arrangements under negotiation, we accrue for estimated royalties based on the available facts and circumstances and adjust these estimates as more information becomes available. The results of any finalized negotiation may be materially different from our estimates.

In July 2009 we, together with other webcasters, negotiated new royalty rates on performances with SoundExchange for calendar years 2006 to 2015. The agreement reduced rates originally established by the Copyright Royalty Board for calendar years 2006 to 2010 and established new rates for calendar years 2011 to 2015.

Cost of Revenue Other. Cost of revenue consists of hosting costs, infrastructure and the employee and employee-related costs associated with supporting those functions. Hosting costs consist of content streaming, maintaining our internet radio service and creating and serving advertisements through third-party ad servers. Infrastructure costs consist of equipment, software, facilities and depreciation. We make payments to third-party ad servers for the period the advertising impressions or click-through actions are delivered or occur, and accordingly, we record this as a cost of revenue in the related period.

Product Development. Product development expenses consist of employee compensation, information technology, consulting, facilities-related expenses and costs associated with supporting consumer connected-device manufacturers in implementing our service in their products. We incur product development expenses primarily for improvements to our website and the Pandora app, development of new advertising products and development and enhancement of our personalized station(s) generating system. We have generally expensed product development as incurred. Certain website development and internal use software development costs may be capitalized when specific criteria are met. In such cases, the capitalized amounts are amortized over the useful life of the related application once the application is placed in service. We intend to continue making significant investments in developing new products and enhancing the functionality of our existing products.

Marketing and Sales. Marketing and sales expenses consist of employee and employee-related costs including salaries, commissions and benefits related to employees in sales, marketing and advertising departments. In addition, marketing and sales expenses include external sales and marketing expenses such as third-party marketing, branding, advertising, and public relations expenses, transactional subscription processing fees on mobile platforms, and infrastructure costs such as facility and other supporting overhead costs. We expect marketing and

Edgar Filing: Pandora Media, Inc. - Form 10-Q

sales expenses to increase as we hire additional personnel to build out our sales force and ad operations team and expand our business development team to establish relationships with manufacturers of an increasing number of connected devices.

General and Administrative. General and administrative expenses include employee and employee-related costs consisting of salaries and benefits for finance, accounting, legal, internal information technology and other administrative personnel. In addition, general and administrative expenses include professional services costs for outside legal and accounting services, and infrastructure costs for facility, supporting overhead costs and merchant and other transaction costs, such as credit card fees. We expect to incur significant additional expenses in future periods as we continue to invest in corporate infrastructure, including adding personnel and systems to our finance and administrative functions.

Provision for Income Taxes. We have historically been subject to income taxes only in the United States. As we expand our operations outside the United States, we have become subject to taxation based on the foreign statutory rates and our effective tax rate could fluctuate accordingly.

Table of Contents

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted statutory income tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized.

Results of Operations

The following table presents our results of operations for the periods indicated as a percentage of total revenue. The period-to-period comparisons of results are not necessarily indicative of results for future periods.

Table of Contents

	Three Months Ended April 30,	
	2012(2)	2013(2)
	(unaudited)	
Revenue:		
Advertising	87%	84%
Subscription services and other	13	16
Total revenue	100	100
Costs and expenses:		
Cost of revenue - Content acquisition costs	69	66
Cost of revenue - Other(1)	9	8
Product development(1)	5	6
Marketing and sales(1)	29	32
General and administrative(1)	13	11
Total costs and expenses	125	123
Loss from operations	(25)	(23)
Other income (expense):		
Interest income		
Interest expense		
Other expense, net		
Loss before provision for income taxes	(25)	(23)
Provision for income taxes		
Net loss	(25)%	(23)%

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	0.3%	0.4%
Product development	1.2	1.4
Marketing and sales	3.6	3.9
General and administrative	1.6	0.3

(2) Amounts may not sum due to rounding

Comparison of the Three Months Ended April 30, 2012 and 2013

Revenue

	Three Months Ended April 30,			\$ Change
	2012	2013 (in thousands)		
Advertising	\$ 70,597	\$ 105,146	\$ 34,549	
Subscription services and other	10,187	20,364	10,177	

Table of Contents

which increased the volume of advertising inventory as well as an increase in our sales force by approximately 73% year-over-year to sell such advertising inventory. Subscription revenue increased \$10.2 million due to an increase in the number of subscribers, partially driven by the implementation of the mobile listening limit.

Total ad RPMs three months ended 2012 compared to 2013. Total ad RPMs increased compared to the respective prior year period due to advertising sales growth outpacing the growth in advertising listener hours in part due to the effect of the listening limit on certain mobile and other connected devices.

Costs and Expenses

Cost of Revenue - Content acquisition costs

	Three Months Ended April 30,		\$ Change
	2012	2013 (in thousands)	
Cost of Revenue - Content acquisition costs	\$ 55,818	\$ 82,853	\$ 27,035

The following table presents our estimated content acquisition costs for our advertising-based service attributable to our traditional computer platform and our mobile and other connected devices platforms as percentages of the estimated advertising revenue attributable to such platforms.

	Three Months Ended April 30,	
	2012	2013
Traditional computer	39%	39%
Mobile and other connected devices	94%	78%

The majority of our royalties are payable based on a fee per track, while in other cases our royalties are payable based on a percentage of our revenue or a combination of per track and revenue metrics. We estimate our advertising-based content acquisition costs attributable to specific platforms by allocating costs from royalties payable based on a fee per track to the platform for which the track is served and by allocating costs from royalties based on a percentage of our revenue in accordance with the overall percentage of our revenue estimated to be attributable to such platforms. While we believe that comparing disaggregated content acquisition costs and revenues across our delivery platforms may provide directional insight for evaluating our efforts to monetize the rapid adoption of our service on mobile and other connected devices, we do not validate such disaggregated metrics to the level of financial statement reporting. We continue to refine our systems and methodologies used to categorize such metrics across our delivery platforms and the period-to-period comparisons of results are not necessarily indicative of results for future periods.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

Three months ended 2012 compared to 2013. Content acquisition costs increased \$27.0 million due to increased royalty payments driven by increased listener hours and higher royalty rates due to scheduled rate increases, and higher revenue. Content acquisition costs as a percentage of total revenue decreased from 69% to 66%, primarily due to an increase in advertising sales and the effect of the mobile listening limit, partially offset by scheduled rate increases. Estimated content acquisition costs as a percentage of the revenue attributable to our traditional computer platform remained flat at 39%, as rate increases were offset by growth in advertising sales on that platform. Estimated content acquisition costs as a percentage of the revenue attributable to our mobile and other connected devices platforms decreased from 94% to 78%, primarily due to an increase in advertising sales on those platforms and the effect of the mobile listening limit, partially offset by scheduled rate increases.

Table of Contents*Cost of Revenue - Other*

		Three Months Ended April 30,				
		2012	2013	\$ Change		
		(in thousands)				
Cost of revenue	Other	\$ 6,917	\$ 9,779	\$	2,862	

Three months ended 2012 compared to 2013. Cost of revenue increased \$2.9 million due to a \$2.2 million increase in hosting services costs as a result of a 35% increase in listener hours and a \$0.6 million increase in employee-related expenses driven by a 16% increase in headcount.

Product Development

		Three Months Ended April 30,				
		2012	2013	\$ Change		
		(in thousands)				
Product development		\$ 4,119	\$ 7,033	\$	2,914	

Three months ended 2012 compared to 2013. Product development expenses increased \$2.9 million primarily due to \$2.8 million higher employee-related expenses driven by a 45% increase in headcount.

Marketing and Sales

		Three Months Ended April 30,				
		2012	2013	\$ Change		
		(in thousands)				
Marketing and sales		\$ 23,460	\$ 40,083	\$	16,623	

Three months ended 2012 Compared to 2013. Marketing and sales expenses increased \$16.6 million primarily due to \$10.6 million higher employee-related costs, driven by a 67% increase in headcount, an increase in marketing expenses of \$4.9 million primarily related to a \$4.2 million increase in transactional subscription processing fees on mobile platforms and marketing research and event costs, and \$1.2 million in higher infrastructure costs related to facilities and equipment.

General and Administrative

Edgar Filing: Pandora Media, Inc. - Form 10-Q

	Three Months Ended			\$ Change		
	2012	April 30,			2013	
			(in thousands)			
General and administrative	\$	10,612	\$	14,209	\$	3,597

Three months ended 2012 compared to 2013. General and administrative expenses increased \$3.6 million primarily due to a \$1.7 million increase in employee-related expenses driven by a 42% increase in headcount including \$1.0 million lower stock-based compensation expenses primarily due to the effect of changes in estimates and assumptions related to an executive's stock-based compensation award. A \$1.1 million increase in infrastructure costs and a \$0.9 million increase in professional fees drove the remainder of the \$3.6 million increase.

Table of Contents***Other Income (Expense)***

	Three Months Ended			\$ Change		
	2012	April 30,			2013	
		(in thousands)				
Interest income	\$	32	\$	15	\$	(17)
Interest expense		(124)		(143)		(19)
Other income (expense)				1		1
Total other expense	\$	(92)	\$	(127)	\$	(35)

Three months ended 2012 compared to 2013. Total other expense increased \$35,000 primarily driven by a \$19,000 increase in interest expense and a \$17,000 decrease in interest income.

Provision for Income Taxes

Three months ended 2012 compared to 2013. The income tax provision increased by \$19,000 as a result of changes in states tax rules and additional international tax expense.

Off-Balance Sheet Arrangements

Our liquidity is not dependent on the use of off-balance sheet financing arrangements and as of April 30, 2013 we had no such arrangements. There has been no material change in our contractual obligations other than in the ordinary course of business since our fiscal year ended January 31, 2013.

Quarterly Trends

Our operating results fluctuate from quarter to quarter as a result of a variety of factors. We expect our operating results to continue to fluctuate in future quarters.

Our results may reflect the effects of some seasonal trends in listener behavior due to increased internet usage and sales of media-streaming devices during certain vacation and holiday periods. For example, we expect to experience increased usage during the fourth quarter of each calendar year due to the holiday season, and in the first quarter of each calendar year due to increased use of media-streaming devices received as gifts during the holiday season. We may also experience higher advertising sales during the fourth quarter of each calendar year due to greater advertiser demand during the holiday season and lower advertising sales during the first quarter of each calendar year due to seasonally adjusted advertising demand. While we believe these seasonal trends have affected and will continue to affect our operating results, particularly as

Edgar Filing: Pandora Media, Inc. - Form 10-Q

increases in content acquisition costs from increased usage are not offset by increases in advertising sales in the last month of our fourth fiscal quarter, our trajectory of rapid growth may have overshadowed these effects to date. We believe that our business may become more seasonal in the future and that such seasonal variations in listener behavior may result in fluctuations in our financial results.

In addition, expenditures by advertisers tend to be cyclical and discretionary in nature, reflecting overall economic conditions, the economic prospects of specific advertisers or industries, budgeting constraints and buying patterns and a variety of other factors, many of which are outside our control. As a result of these and other factors, the results of any prior quarterly or annual periods should not be relied upon as indications of our future operating performance.

We continue to see growth in listener hours on mobile and other connected devices outpacing growth in listener hours on traditional computers. The growth in listener hours on mobile and other connected devices was tempered in the three months ended April 30, 2013 by the implementation of the mobile listening limit for our advertising supported service on certain mobile and other connected devices. To the extent we take steps such as these to affect usage on a particular platform, trends in usage may be obscured or changed and comparisons across periods may not be meaningful.

Liquidity and Capital Resources

As of April 30, 2013 we had cash, cash equivalents and short-term investments totaling \$75.4 million, which consisted of cash and money market funds held at major financial institutions, commercial paper and investment-grade corporate debt securities. Our principal uses of cash during the three months ending April 30, 2013 were funding our operations, as described below, and capital expenditures.

Table of Contents

Sources of Funds

We believe, based on our current operating plan, that our existing cash and cash equivalents and available borrowings under our credit facility will be sufficient to meet our anticipated cash needs for at least the next 12 months.

From time to time, we may explore additional financing sources and means to lower our cost of capital, which could include equity, equity-linked and debt financing. In addition, in connection with any future acquisitions, we may require additional funding which may be provided in the form of additional debt, equity or equity-linked financing or a combination thereof. There can be no assurance that any additional financing will be available to us on acceptable terms.

Our Indebtedness

Credit Facility. On May 13, 2011, we entered into a \$30 million credit facility with a syndicate of financial institutions. The amount of borrowings available under the credit facility at any time is based on our monthly accounts receivable balance at such time, and the amounts borrowed are collateralized by our personal property (including such accounts receivable but excluding intellectual property). Under the credit facility, we can request up to \$5 million in letters of credit be issued by the financial institutions.

As of April 30, 2013, the Company had \$828,000 in letters of credit outstanding and had \$29.17 million of available borrowing capacity under the credit facility. On December 30, 2011, the Company entered into a cash collateral agreement in connection with the issuance of letters of credit which were used to satisfy deposit requirements under facility leases. As of April 30, 2013, the \$828,000 cash collateral was considered to be restricted cash. The amount is included in other assets on the Company's balance sheet.

Capital Expenditures

Consistent with previous periods, future capital expenditures will primarily focus on acquiring additional hosting and general corporate infrastructure. We believe that our existing cash, cash equivalents, short-term investments and available borrowings are sufficient to fund our anticipated capital expenditures.

Historical Trends

The following table summarizes our cash flow data for the three months ended April 30, 2012 and 2013.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

	Three Months Ended April 30,	
	2012	2013
	(in thousands)	
	(unaudited)	
Net cash used in operating activities	\$ (10,580)	\$ (12,608)
Net cash provided by (used in) investing activities	9,216	(1,215)
Net cash provided by financing activities	1,928	3,530

Operating Activities

In the three months ended April 30, 2012, net cash used in operating activities was \$10.6 million, including our net loss of \$20.2 million and non-cash charges of \$7.2 million. Net cash used in operating activities included \$3.8 million higher accounts receivable primarily due to increased billings, and \$2.4 lower accrued compensation due commission and bonus payments, partially offset by \$4.3 million higher accrued royalties due to an increase in listening hours and scheduled royalty rate increases, \$2.5 million higher deferred revenue due to an increase in customers purchasing subscriptions for Pandora One and a \$1.2 million reimbursement of leasehold improvement costs related to our Oakland, California facility.

In the three months ended April 30, 2013, net cash used in operating activities was \$12.6 million, including our net loss of \$28.6 million and non-cash charges of \$9.6 million, primarily related to stock-based compensation charges. Net cash used in operating activities benefited from changes in operating assets and liabilities including an \$8.0 million increase in deferred revenue primarily due to an increase in customers purchasing subscriptions for Pandora One, partially driven by the implementation of the mobile listening limit, a \$2.9 million increase in accounts payable and accrued liabilities due to the timing of payments, a \$2.6 million increase in accrued royalties due to increased listening hours and scheduled royalty rate increases. These increases were partially offset by \$5.4 million lower accrued compensation primarily due to the timing of commission, bonus and payroll payments.

Table of Contents

Investing Activities

Cash provided by investing activities in the three months ended April 30, 2012 was \$9.2 million consisting of \$28.1 million in maturities of short-term investments, partially offset by \$17.6 million in purchases of short-term investments and \$1.2 million in capital expenditures primarily related to leasehold improvements.

Cash used in investing activities in the three months ended April 30, 2013 was \$1.2 million consisting of \$10.8 million for the purchase of short-term investments and \$4.4 million for capital expenditures primarily for server equipment and leasehold improvements, partially offset by \$14.0 million in maturities of short-term investments.

Financing Activities

Cash provided by financing activities in the three months ended April 30, 2012 was \$1.9 million consisting of proceeds from issuance of common stock.

Cash provided by financing activities in the three months ended April 30, 2013 was \$3.5 million consisting of cash proceeds from issuance of common stock.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

There have been no material changes to our critical accounting policies and estimates as compared to those described in our Annual Report on Form 10-K for the fiscal year ended January 31, 2013 under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

There have been no material changes in our primary market risk exposures or how those exposures are managed from the information disclosed in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended January 31, 2013. For further discussion of quantitative and qualitative disclosures about market risk, reference is made to our Annual Report on Form 10-K.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Based on their evaluation at the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of April 30, 2013.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the three months ended April 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The material set forth in Note 5 of Notes to Condensed Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors

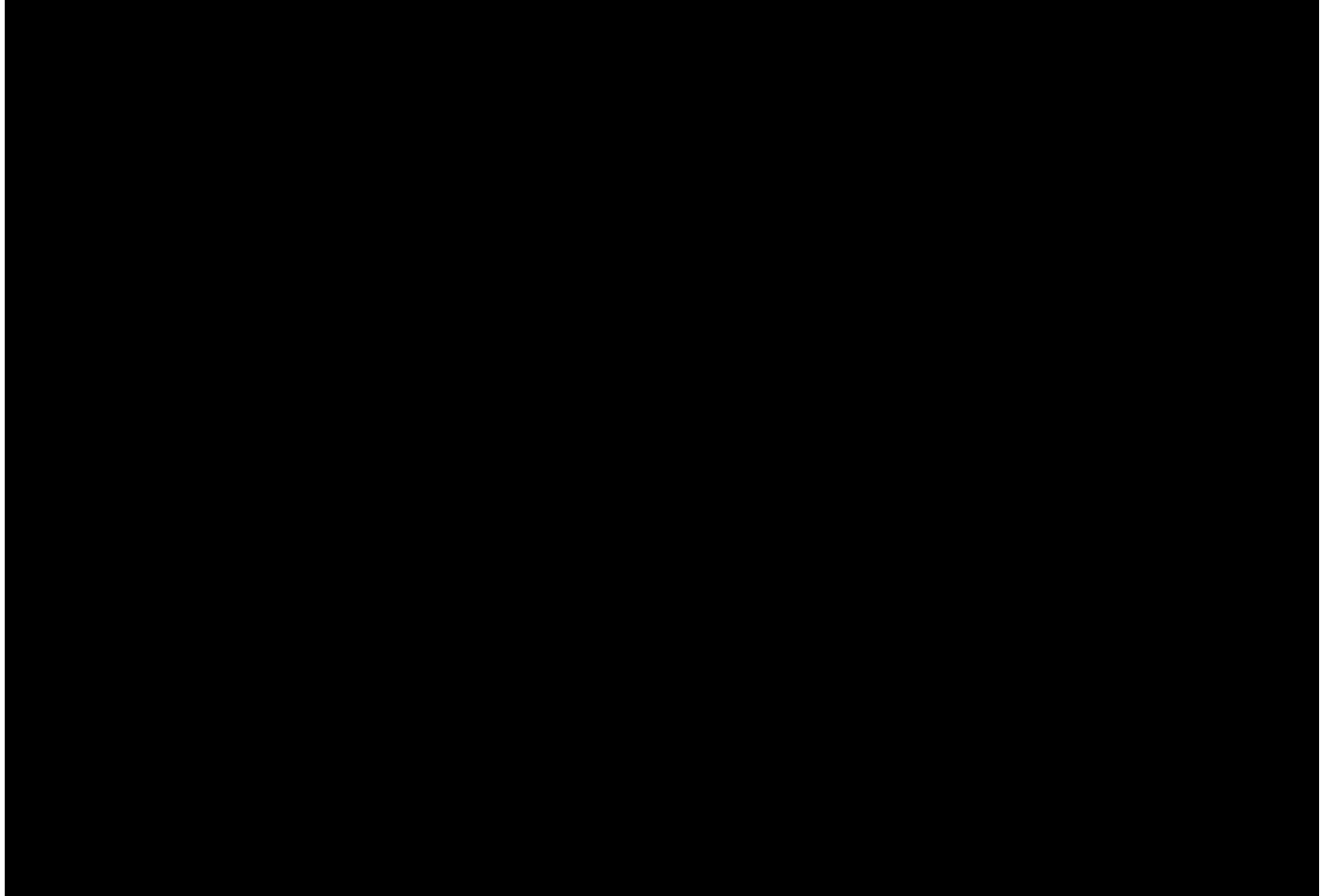
Investing in our common stock involves a high degree of risk. Before deciding to invest in our common stock, you should carefully consider each of the risk factors described in Part I - Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended January 31, 2013 and all information set forth in this Quarterly Report on Form 10-Q. Those risks and the risks described in this Quarterly Report on Form 10-Q, including in the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations, could materially harm our business, financial condition, operating results, cash flow and prospects. If that occurs, the trading price of our common stock could decline, and you may lose all or part of your investment.

There have been no material changes to the Risk Factors described under Part I - Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended January 31, 2013.

Table of Contents

Item 6. Exhibits

Exhibit No.	Exhibit Description	Form	File No.	Incorporated by Reference		Filed By	Filed Herewith
				Exhibit	Filing Date		



Indicates management contract or compensatory plan.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Pandora Media, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PANDORA MEDIA, INC.

Date: May 29, 2013

By:

/s/ Michael S. Herring
Michael S. Herring
Executive Vice President and Chief
Financial Officer

(Duly Authorized Officer and Principal Financial and
Accounting Officer)