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Pandora Media, Inc.

Form 10-Q

October 27, 2016

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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 September 30, 2016

or

.. 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 94-3352630

(State or other jurisdiction of
incorporation or organization) (I.R.S. Employer
Identification No.)

2101 Webster Street, Suite 1650 94612
Oakland, CA

(Address of principal executive offices) (Zip Code)
(510) 451-4100

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(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 ☐

Smaller reporting company ☐

(Do not check if a 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 October 25, 2016 was: 233,335,503.

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Pandora Media, Inc.

FORM 10-Q Quarterly Report

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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 December 31, 2015	As of September 30, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 334,667	\$ 207,695
Short-term investments	35,844	50,052
Accounts receivable, net of allowance of \$2,165 at December 31, 2015 and \$3,023 at September 30, 2016	277,075	282,802
Prepaid content acquisition costs	2,099	102,623
Prepaid expenses and other current assets	33,821	34,166
Total current assets	683,506	677,338
Long-term investments	46,369	6,273
Property and equipment, net	66,370	118,453
Goodwill	303,875	306,706
Intangible assets, net	110,745	95,565
Other long-term assets	29,792	32,528
Total assets	\$ 1,240,657	\$ 1,236,863
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 17,897	\$ 13,983
Accrued liabilities	37,185	33,968
Accrued content acquisition costs	97,390	106,275
Accrued compensation	43,788	52,089
Deferred revenue	19,939	31,971
Other current liabilities	15,632	20,739
Total current liabilities	231,831	259,025
Long-term debt, net	234,577	337,429
Other long-term liabilities	30,862	33,402
Total liabilities	497,270	629,856
Stockholders' equity		
Common stock: 224,970,412 shares issued and outstanding at December 31, 2015 and 233,312,446 at September 30, 2016	23	23
Additional paid-in capital	1,110,539	1,227,197
Accumulated deficit	(366,658)	(619,627)
Accumulated other comprehensive loss	(517)	(586)
Total stockholders' equity	743,387	607,007
Total liabilities and stockholders' equity	\$ 1,240,657	\$ 1,236,863

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

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Pandora Media, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2016	2015	2016
Revenue				
Advertising	\$254,656	\$273,716	\$664,316	\$759,150
Subscription and other	56,906	56,100	163,570	165,957
Ticketing service	—	22,085	—	67,121
Total revenue	311,562	351,901	827,886	992,228
Cost of revenue				
Cost of revenue - Content acquisition costs	211,272	174,334	467,429	522,231
Cost of revenue - Other	21,414	25,556	57,690	71,388
Cost of revenue - Ticketing service	—	15,318	—	45,223
Total cost of revenue	232,686	215,208	525,119	638,842
Gross profit	78,876	136,693	302,767	353,386
Operating expenses				
Product development	21,849	33,657	56,466	103,311
Sales and marketing	107,286	116,475	285,595	357,909
General and administrative	35,603	41,768	111,169	128,626
Total operating expenses	164,738	191,900	453,230	589,846
Loss from operations	(85,862)	(55,207)	(150,463)	(236,460)
Interest expense	(131)	(6,494)	(386)	(18,916)
Other income, net	95	579	803	1,696
Total other income (expense), net	(36)	(5,915)	417	(17,220)
Loss before benefit from (provision for) income taxes	(85,898)	(61,122)	(150,046)	(253,680)
Benefit from (provision for) income taxes	(32)	(412)	(206)	711
Net loss	\$(85,930)	\$(61,534)	\$(150,252)	\$(252,969)
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	212,760	232,139	211,487	229,524
Net loss per share, basic and diluted	\$(0.40)	\$(0.27)	\$(0.71)	\$(1.10)

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

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Pandora Media, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2016	2015	2016
Net loss	\$ (85,930)	\$ (61,534)	\$ (150,252)	\$ (252,969)
Change in foreign currency translation adjustment	(127)	(129)	(274)	(417)
Change in net unrealized gains (loss) on marketable securities	50	(45)	324	348
Other comprehensive income (loss)	(77)	(174)	50	(69)
Total comprehensive loss	\$ (86,007)	\$ (61,708)	\$ (150,202)	\$ (253,038)

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

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Pandora Media, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine months ended September 30,	
	2015	2016
Operating activities		
Net loss	\$(150,252)	\$(252,969)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	15,194	43,480
Stock-based compensation	79,473	103,841
Amortization of premium on investments, net	1,712	339
Other operating activities	1,610	2,884
Amortization of debt discount	—	13,587
Changes in operating assets and liabilities		
Accounts receivable	(45,796)	(8,338)
Prepaid content acquisition costs	(167)	(100,524)
Prepaid expenses and other assets	(6,397)	(12,655)
Accounts payable, accrued and other current liabilities	29,601	(4,990)
Accrued content acquisition costs	89,423	8,875
Accrued compensation	4,333	10,370
Other long-term liabilities	1,500	598
Deferred revenue	7,689	12,032
Reimbursement of cost of leasehold improvements	1,014	4,397
Net cash provided by (used in) operating activities	28,937	(179,073)
Investing activities		
Purchases of property and equipment	(21,336)	(46,400)
Internal-use software costs	(5,997)	(22,339)
Changes in restricted cash	—	(250)
Purchases of investments	(138,721)	(12,413)
Proceeds from maturities of investments	179,799	34,816
Proceeds from sale of investments	41,317	3,507
Payments related to acquisitions, net of cash acquired	(23,028)	(676)
Net cash provided by (used in) investing activities	32,034	(43,755)
Financing activities		
Borrowings under debt arrangements	—	90,000
Proceeds from employee stock purchase plan	5,089	6,395
Proceeds from exercise of stock options	3,718	3,011
Payment of debt issuance costs	—	(32)
Tax payments from net share settlements of restricted stock units	(2,295)	(3,126)
Net cash provided by financing activities	6,512	96,248
Effect of exchange rate changes on cash and cash equivalents	(459)	(392)
Net increase (decrease) in cash and cash equivalents	67,024	(126,972)
Cash and cash equivalents at beginning of period	175,957	334,667
Cash and cash equivalents at end of period	\$242,981	\$207,695
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	\$343	\$3,336
Purchases of property and equipment recorded in accounts payable and accrued liabilities	\$1,328	\$8,321

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

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of Business and Basis of Presentation

Pandora

Pandora is the world's most powerful music discovery platform, offering a personalized experience for each of our listeners wherever and whenever they want to listen to music—whether through earbuds, car speakers or live on stage. Our vision is to be the definitive source of music discovery and enjoyment for billions. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We offer both local and national advertisers the opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. We also generate revenue by offering an advertising-free subscription service which we call Pandora Plus. We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010. Our principal operations are located in the United States, and we also operate in Australia, New Zealand and Canada.

Ticketing Service

Ticketfly is a leading live events technology company that provides ticketing and marketing software and services for venues and event promoters across North America. Ticketfly's ticketing, digital marketing and analytics software helps promoters book talent, sell tickets and drive in-venue revenue, while Ticketfly's consumer tools help fans find and purchase tickets to events. Ticketfly's revenue primarily consists of service and merchant processing fees from ticketing operations. We completed the acquisition of Ticketfly on October 31, 2015.

As used herein, "Pandora," "we," "our," "the Company" and similar terms include Pandora Media, Inc. and its subsidiaries, unless the context indicates otherwise.

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") along with the instructions to Form 10-Q and Article 10 of Securities and Exchange Commission ("SEC") Regulation S-X, and include the accounts of Pandora and our wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of our management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of our 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 our Annual Report on Form 10-K for the year ended December 31, 2015.

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. We have reclassified certain amounts from the accounts payable, accrued and other current liabilities line item to the long-term liabilities line item of our condensed consolidated statements of cash flows. We have also reclassified internal-use software costs from the purchases of property and equipment line item to the internal-use software costs line item of our condensed consolidated statements of cash flows. We have also reclassified prepaid content acquisition costs from the prepaid expenses and other assets line item to the prepaid content acquisition costs line item of our condensed consolidated balance sheets and our condensed consolidated statements of cash flows. Lastly, we

have reclassified interest expense from the other income (expense), net line item to the interest expense line item of our condensed consolidated statements 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 in several areas including, but not limited to determining accrued content acquisition costs, amortization of minimum guarantees under content acquisition agreements, selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, the fair value of stock options, market stock units ("MSUs"), stock-settled performance-based RSUs ("PSUs") and the Employee Stock Purchase Plan ("ESPP"), the provision for (benefit from) income taxes and the impact of forfeitures on stock-based compensation. To the extent there are material differences between these estimates, judgments

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Pandora Media, Inc.

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or assumptions and actual results, our financial statements could be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by 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.

2. Summary of Significant Accounting Policies

Other than discussed below, there have been no material changes to our significant accounting policies as compared to those described in our Annual Report on Form 10-K for the year ended December 31, 2015.

Prepaid Content Acquisition Costs

Prepaid content acquisition costs are primarily comprised of minimum guarantees under content acquisition agreements. From November 2015 through September 2016, we signed direct license agreements for recorded music with major and independent labels, distributors and publishers. Certain of these license agreements include minimum guarantee payments, some of which are paid in advance. These minimum guarantees may take the form of either a contractually obligated minimum over a specified period of time that requires a true-up payment at the end of the specified period if the cumulative payments have not met or exceeded the specified minimum, or cash advance payments made at the beginning of, or at intervals during, the specified period, which cash payments are then recoupable against content acquisition costs over the specified period. On a quarterly basis, we record the greater of the cumulative actual content acquisition costs incurred or the cumulative minimum guarantee based on forecasted usage for the minimum guarantee period. The minimum guarantee period is the period of time that the minimum guarantee relates to, as specified in each agreement, which may be annual or a longer period. The cumulative minimum guarantee, based on forecasted usage considers factors such as listening hours, revenue, subscribers and other terms of each agreement that impact our expected attainment or recoupment of the minimum guarantees on a non-straight line basis.

Concentration of Credit Risk

For the three and nine months ended September 30, 2015 and 2016, we had no customers that accounted for more than 10% of our total revenue. As of December 31, 2015 and September 30, 2016, we had no customers that accounted for more than 10% of our total accounts receivable.

Recently Issued Accounting Standards

In March 2016, the Financial Accounting Standards Board ("the FASB") issued Accounting Standards Update No. 2016-09, *Compensation - Stock Compensation (Topic 718)* ("ASU 2016-09"). ASU 2016-09 requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. Additionally, it allows an employer to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within that fiscal year, although early adoption is permitted. We are currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial statements upon adoption.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, *Going Concern (Subtopic 205-40)* ("ASU 2014-15"). ASU 2014-15 requires management of all entities to evaluate whether there are conditions

and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued when applicable). The guidance is effective for fiscal years beginning after December 15, 2016 and for interim periods within that fiscal year. We do not expect the adoption of this guidance to have a material effect on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-9, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-9"). ASU 2014-9 outlines a single comprehensive model for entities to use in accounting for revenue. Under the guidance, revenue is recognized when a company transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The standard may be effective for public entities with annual and interim reporting periods beginning after December 15, 2017. Entities have the option of using either a full retrospective or a modified retrospective approach to adopt the guidance. We are

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currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial statements upon adoption.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 requires lessees to put most leases on their balance sheets but recognize expenses on their income statement and eliminates the real estate-specific provisions for all entities. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial statements upon adoption.

3. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments consisted of the following:

	As of December 31, 2015 (in thousands)	As of September 30, 2016
Cash and cash equivalents		
Cash	\$ 104,361	\$ 130,132
Money market funds	180,021	33,446
Commercial paper	31,089	35,904
Corporate debt securities	2,000	8,213
U.S. government and government agency debt securities	17,196	—
Total cash and cash equivalents	\$ 334,667	\$ 207,695
Short-term investments		
Commercial paper	\$ 4,792	\$ 1,000
Corporate debt securities	31,052	49,052
Total short-term investments	\$ 35,844	\$ 50,052
Long-term investments		
Corporate debt securities	\$ 46,369	\$ 6,273
Total long-term investments	\$ 46,369	\$ 6,273
Cash, cash equivalents and investments	\$ 416,880	\$ 264,020

Our short-term investments have maturities of twelve months or less and are classified as available-for-sale. Our long-term investments have maturities of greater than twelve months and are classified as available-for-sale.

The following tables summarize our available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of December 31, 2015 and September 30, 2016.

As of December 31, 2015			
Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
(in thousands)			

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Money market funds	\$ 180,021	\$ —	\$ —	\$ 180,021
Commercial paper	35,881	—	—	35,881
Corporate debt securities	79,760	8	(347) 79,421
U.S. government and government agency debt securities	17,198	—	(2) 17,196
Total cash equivalents and marketable securities	\$ 312,860	\$ 8	\$ (349) \$ 312,519

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Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

	As of September 30, 2016			
	Adjusted	Unrealized	Unrealized	Fair
	Cost	Gains	Losses	Value
	(in thousands)			
Money market funds	\$33,446	\$ —	\$ —	\$33,446
Commercial paper	36,904	—	—	36,904
Corporate debt securities	63,531	26	(19)	63,538
Total cash equivalents and marketable securities	\$133,881			