



1 **Pandora (P) Q215 Financial Results Conference Call July 23, 2015**

2 **Scripts for: Brian McAndrews, Chairman, CEO, & President**

3 **Mike Herring, Chief Financial Officer, Pandora**

4 **Dominic Paschel, Vice President, Pandora**

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6 **FINAL – July 23, 2015**

7 **Dominic Paschel**

8 Good afternoon and welcome to Pandora's second quarter 2015 financial results call for the
9 quarter ended June 30, 2015. Some of our discussions will contain forward-looking statements
10 which may include projected financial results or operating metrics, business strategies,
11 anticipated future products or services, anticipated market demand or opportunities and other
12 forward-looking topics.

13
14 These statements are subject to risks, uncertainties, and assumptions. Accordingly, actual
15 results could differ materially. For a discussion of the risks that could cause our results to differ
16 from today's discussion, please refer to the documents we file with the Securities and Exchange
17 Commission.

18
19 Also, I would like to remind you that during the course of this conference call, we will discuss
20 non-GAAP measures of our performance. Reconciliations to the most directly comparable GAAP
21 financial measures are provided in the tables in the press release and form 8-K filed earlier this
22 afternoon with the SEC. For your convenience, supplemental information has been included in
23 today's press release and detailed financials are available on the Investor Relations site.

24
25 Today's call is available via webcast and a replay will be available for two weeks following the
26 conclusion of the call. We will also post the full text of today's prepared remarks once Mike
27 concludes. To access the prepared remarks, press release, supplemental financial information,

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28 or the webcast replay, please consult the Investor Relations section of Pandora.com. With that,
29 let me turn the call over to Brian McAndrews, Pandora's Chairman and CEO.

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30 **Brian McAndrews**

31 Thanks, Dom, and thank you all for being on the call today. I am looking forward to discussing
32 our **STRONG** quarter and the progress we've made across several business initiatives.

33
34 Let me begin with the financial highlights. In the second quarter we saw our monetization
35 engine hit its stride with revenue reaching \$285.6 million, *a new all-time high and an increase*
36 *of 30% year-over-year*. The end of the second quarter also marks a **significant** revenue
37 milestone for Pandora. We can officially say we have crossed the threshold of a *billion dollars*
38 *in revenue* for the trailing four quarters. This is a major milestone for the company and
39 something we are incredibly proud of. From an earnings perspective, our increased revenue
40 drove adjusted EBITDA of \$16.3 million, and our non-GAAP second quarter net income was
41 \$11.6 million, or non-GAAP earnings per share of \$0.05.

42
43 As we dive into the broader metrics of the business, we'll start with audience, where we
44 continue to drive multi-dimensional growth. In terms of listeners, as of the end of June 2015 —
45 traditionally a seasonal low-point — monthly active users were 79.4 million, an increase of 4%
46 over last June and up slightly from last quarter. Our listeners continue to be increasingly
47 engaged, as listening hours per active user grew to 22.2 hours this quarter. Total listener hours
48 were 5.3B for the quarter, a 5% increase from this time last year. As noted previously, this is
49 traditionally a seasonally lower point, when people are on vacation and away from work and
50 also spending more time in their cars, where, while we are a leader in streaming radio, we are
51 still in the early days of developing our market share. It's also important to note that very
52 positive product improvements have, paradoxically, had a dampening effect in reported hours.
53 Let me explain. Significant improvements to our new user interface, which launched in
54 February, and continued step functions in better playlisting have markedly improved our
55 success in our never-ending quest to always play the perfect song to each person at the right
56 time. These positive improvements in the listening experience have resulted in less song
57 skipping, thus reducing the number of songs paid for but not fully played. As a reminder,

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58 Pandora's reported listening hours are based on server side counts. As the ratio of fully
59 completed songs to hours improves, reported server hours are thus reduced due to these
60 listener improvements. This is **actually** a very positive sign about the long-term health and
61 potential of our business, despite the short-term impact it can have on reported listener hours.

62
63 By our estimates, Pandora's share of all US radio listening is 9.47% as of June 30th, up from
64 8.9% at the same time last year, slightly lower than the first quarter, and consistent with our
65 typical seasonal pattern. As measured by comScore, Pandora's total multi-platform unique
66 visitors in June grew 4% year-over-year to 84.9 million. In terms of engagement, comScore's
67 June Mobile Metrix report ranked Pandora as the #2 mobile service in the US in terms of
68 average minutes per user. **This is significant.** Only Facebook, whose metrics now include
69 Messenger, Instagram, and WhatsApp properties, was higher. Pandora's engagement metrics
70 were more than double the next closest mobile service and 138% higher than the next largest
71 mobile *music* service, even with our much larger user base.

72
73 While we continue to grow our audience, our monetization efforts have **really hit their stride.**
74 Total RPMs reached a **record** high of \$53.91 during the quarter, an **impressive** \$10.50 increase
75 year-over-year and \$2.37 higher than Q4—traditionally our seasonal peak. Ad RPMs were up
76 25% year-over-year to a **record** \$49.94.

77
78 These **record** high RPMs are driven primarily by our continued success in local, which is driving
79 increased sell-through of premium advertising units and increased pricing across video, display
80 and audio. We have built a **highly** productive, local team that is nearly **double** the size of the
81 2013 local sales force with a strong presence in 38 markets, managing a record 7,000 accounts.
82 During the second quarter, local ad revenue grew 67% year-over-year and represented a **record**
83 26% of total ad revenue.

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85 Our **leadership** position in the advertising industry extends beyond the strength of our
86 monetization of mobile. As an active participant at Cannes Lyon, where ad tech was a focus this
87 year, we led many conversations about the power of music for marketers and how technology
88 and artists continue to evolve to shape brand marketing strategies. Closer to home, we
89 launched our new programmatic offering in mid-June ahead of the Q3 schedule, and we are
90 very pleased with the early advertiser interest and reaction, which we expect to translate to
91 more meaningful revenue in 2016. This is a nascent category, one we are helping to define and
92 educate marketers on — one with huge potential.

93

94 We also **continue** to lead by bringing brands unique ways to connect with their audiences
95 through music. With our Pandora Country event at the CMA Festival, we connected brands
96 such as Kingsford, Velveeta, Folgers, and Bud Light with over 900 passionate country music fans
97 of Dustin Lynch, Thompson Square and new country superstar Kelsea Ballerini. We also created
98 an innovative partnership with Ford F-Series trucks to bring a new kind of experience to country
99 listeners via a custom content station. The station features an exclusive episodic radio program
100 narrated and hosted by songwriter Otis Gibbs that includes custom-curated mixtapes,
101 interviews, exclusive performances, and behind-the-scenes videos. You should try it out if you
102 are a country fan — it's fascinating history.

103 In addition to helping marketers evolve their brand marketing strategies and connect to
104 customers through music, we are rapidly becoming an indispensable partner to Music Makers
105 by helping artists evolve their promotional tactics to better connect to their audiences and
106 grow their revenue. Through our Music Maker initiatives, in Q2 alone, we connected artists
107 with **more than 5 million listeners** with various content programs, including featuring new
108 albums on Pandora Premieres with about 40 artists and creating more than 15 mixtapes for
109 artists including the *Rolling Stones*, *Major Lazer*, and *Mumford & Sons*. We also enabled artists
110 to engage with thousands of attendees across numerous live events, including the Sonos
111 Studios and Pandora concert series programs featuring *Mikky Ekko* and *Marina and the*

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112 *Diamonds*, Noche de Musica, Hangout Festival, Coachella, and an exclusive live performance in
113 New York City with Warner Bros.' multi-Platinum artist *Josh Groban*.

114 We are now regularly leveraging our unmatched scale and data expertise to drive new and
115 innovative collaborations with artists and their labels. In June we partnered with **Mumford &**
116 **Sons** and Glassnote Records to live stream the band's sold out show at the Merriweather Post
117 Pavilion in Maryland. The "Mumford & Sons Live" station had more than 1 million station adds
118 -- a huge number in a very short time -- once again demonstrating the unique power of Pandora
119 in connecting artists to their fans at scale, regardless of where they are. You'll recall last
120 quarter we partnered with *Jack White* and his label Third Man Records to similarly live stream
121 his Madison Square Garden concert.

122 In addition to major artists like *Jack White*, *Mumford and Sons*, and *The Rolling Stones*, we are
123 now expanding these same types of promotional collaborations to emerging artists, with
124 remarkable success. Early in the year, using Pandora's proprietary data, we identified *ODESZA*
125 as a rapidly rising, up and coming electronic dance music duo. We sat down with *ODESZA*'s
126 management team to show them the Pandora data. **Impressed** by what they saw, *ODESZA*
127 partnered with Pandora in June to kick off the "In Return" Tour with an exclusive
128 announcement and 24-hour ticket presale, in addition to a custom station curated by *ODESZA*
129 themselves. As Harrison Mills of *ODESZA* said in Fast Company: "When we're marketing our
130 shows in specific regions on Pandora, we know that we're reaching potential fans because
131 they're choosing to listen to our music. So far it's had a huge impact on our upcoming Fall tour.
132 They've been selling out their allocation in minutes."

133 And, in fact, using our ability to identify and message to fans in targeted geographies, we sold
134 out our ticket allotment for the New York tour stop in **just 18 minutes**. Similarly impressive
135 results happened in Washington DC, Seattle, Atlanta, Boston, and more, resulting in *ODESZA*
136 increasing our ticket allotments across the board. Thousands of tickets were sold overall and
137 more than 75 thousand *ODESZA* stations were added. Starting with fans discovering *ODESZA*

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138 on Pandora and culminating in this very successful tour, Pandora amplified the voice of this
139 relatively unknown but incredibly talented duo by using our platform, giving them access to
140 reach more fans in multiple markets and sell-out their shows. Such a unique platform with **this**
141 capability, at **this** scale *has simply never existed before*. This program is a small window and
142 glimpse into what the future of the music industry will look like, and the central role Pandora
143 will play in it.

144 Further exemplifying our total commitment to connecting music makers and listeners, we
145 announced the acquisition of Next Big Sound during the quarter. Next Big Sound was honored
146 several years ago as one of the 10 best digital music startups by Billboard Magazine , and, more
147 recently, CEO Alex White was named to Billboard's 30-Under-30 executives to watch list. We're
148 **excited** to welcome the entire Next Big Sound team to the Pandora family to do **great** things.
149 Next Big Sound gives Pandora a powerful analytics tool used by tens of thousands of music
150 makers, labels and marketers looking for data and insights about artists and their fans. Next Big
151 Sound's capabilities will meaningfully enhance Pandora's data-driven Artist Marketing Platform,
152 which continues to gain momentum. Similarly, Pandora's data, which reflects insights from
153 nearly 80 million active monthly users, will be added to Next Big Sound's offering to deliver an
154 **unprecedented** trove of information to the music industry.

155 These are just some of the examples from our most recent quarter that demonstrate how
156 Pandora is **much more** than a great music service. Pandora is a powerful platform with the
157 ability to connect artists and listeners promotionally, along with the ability to provide valuable
158 insight and intelligence to the entire music ecosystem. In addition to helping established
159 artists strengthen and, in many cases, re-energize their careers, Pandora is uniquely positioned
160 to introduce people to the greatest variety of **NEW** music from bands and artists that they've
161 never heard of before, which can help break new artists and drive revenue opportunities for all.
162 Pandora as a platform is **both** a match maker and a market maker.

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164 As you can see, this was an exciting quarter for Pandora on many fronts. Our continued ability
165 to grow our monetization efficiency is opening up new options for the future. We have
166 surpassed \$1B in revenue for the trailing 12 month period, total RPMs reached record levels
167 across the board, and local advertising reached a record 26% of total ad revenue. Monetizing
168 free audio listening is a fantastically difficult problem to solve, and we are alone in solving it.
169 With each passing month, we are ever more confident about our ability in this area, and we
170 intend to take an increasingly **aggressive** approach to leveraging this distinct competitive
171 advantage. We continue to expand our music industry relationships and develop creative new
172 partnerships with our Music Makers Group. We are now working actively with all our partners
173 in the music industry on multiple fronts to capitalize on the numerous opportunities in front of
174 all of us. As we head into the second half of the year, we look forward to launching **further**
175 product innovations and listener enhancements, while ramping up our brand marketing
176 campaign that kicks off in September. With that, I'd like to turn the call over to Mike Herring,
177 our Chief Financial Officer for more details regarding our financials.

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178 **Mike Herring**

179 Thank you, Brian. I'll walk through our second quarter financials and explain in more detail
180 what's driving our results before providing guidance for the third quarter and full year 2015.

181
182 Starting with revenue, we ended the second quarter of 2015 with total revenue of \$285.6
183 million, representing 30% growth from the year-ago quarter and was above our guidance range
184 of \$280 million to \$285 million and an all-time quarterly high for the company.

185
186 Advertising revenue increased 30% in the second quarter of 2015 to \$230.9 million, compared
187 to \$177.3 million in revenue in the same quarter last year. Second quarter subscription and
188 other revenue was \$54.6 million, an increase of 31% over \$41.6 million in the same period in
189 2014. Our end of period paid subscribers increased approximately 130,000 to 3.91 million, an
190 increase of approximately 15% year-over-year.

191
192 For the quarter, adjusted EBITDA was \$16.3 million, a 29% improvement year over year from
193 Q2 2014 and substantially better than our provided guidance range of \$8 to \$13 million.
194 Adjusted EBITDA excludes \$27.5 million in expense from stock-based compensation, \$5.0
195 million of depreciation and amortization expense, approximately \$115,000 provision for income
196 taxes, and approximately \$256,000 in other income. The EBITDA beat is a combination of
197 revenue strength and a careful roll out of our investments in marketing spend. We have
198 focused on deliberate spending that drives a positive ROI, and as monetization continues to
199 improve we will expand our investments accordingly.

200
201 As mentioned in our Q1 call, this year we will begin adjusting our non-GAAP income by
202 considering the income tax effects of our non-GAAP adjustments. Prior to 2015, our non-GAAP
203 tax rate was minimal. As expected in the second quarter 2015, our non-GAAP effective tax rate
204 was immaterial due to our non-GAAP net loss position. We are currently forecasting a non-
205 GAAP tax rate of approximately 1% to 7% for the third quarter and approximately 30% to 35%

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206 for the full year 2015 to be used when calculating non-GAAP net income and non-GAAP EPS.
207 Despite this, we do not expect to pay significant cash income taxes for the foreseeable future
208 due to our net operating loss position.

209
210 Second quarter 2015 GAAP basic and diluted loss per share was \$0.08. Basic and diluted non-
211 GAAP earnings per share was \$0.05, which excludes approximately \$27.5 million in stock-based
212 compensation expense and approximately \$183,000 in amortization of intangibles. GAAP basic
213 and diluted and non-GAAP basic EPS were based on 211.7 million weighted average shares
214 outstanding. Non-GAAP diluted EPS is based on 221.3 diluted shares outstanding.

215
216 We continued to leverage our content costs, which represented 46% of total revenue in Q2, an
217 improvement of approximately 500 basis points over Q2 2014 based on total revenue. As we
218 have previously emphasized, our ability to leverage these costs is dependent on our ability to
219 increase RPMs in excess of our LPMs. Q2 2015 total RPMs reached a record high of \$53.91
220 growing by \$10.50, or 24%, compared to the year ago period and increased 5%, or \$2.37
221 compared to Q4 2014, our previous record quarter. For the second quarter, total LPMs
222 increased only 11% year over year to \$24.57, lagging RPM growth by 13 percentage points as
223 compared to 11 percentage points in Q1. Total web RPM and total mobile RPM for the second
224 quarter were \$73.48 and \$50.63, respectively. Web advertising RPM reached \$74.35 and
225 mobile advertising RPM reached \$46.15. This quarter, adjustments to our playlist technology to
226 improve the listener experience and reduce skipping resulted in fewer recorded listening hours
227 as well as a decrease in corresponding content costs. Year-over-year increases in RPM were
228 driven by higher direct sell-through rates along with an increase in premium pricing, driven by
229 momentum in local sales. Year-to-date 2015 local advertising revenue was at an all-time high
230 of 26% with 151 local sales people now in market, up from 109 a year ago.

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232 As a demonstration of our massive scale, Pandora is proud to say that we are on-track to have
233 paid more than \$1.5 billion in total royalties at the end of this month. We are happy to
234 contribute to the artist economy in a meaningful way.

235
236 During the second quarter, non-GAAP gross margins expanded approximately 500 basis points
237 from 43% in the year-ago quarter to 48%, and, as we've said previously, we expect this trend to
238 continue in the second half of the year as we progress toward our gross margin target of 60% of
239 revenue.

240
241 Turning to operating expenses, we increased headcount 34% year-over-year to 1,746
242 employees in the second quarter of calendar year 2015, from 1,305 employees in the same
243 period last year. This increase was primarily the result of new additions to our sales team, as
244 we added over 100 sales people year-over-year, and ended the quarter with 443 QBSRs.

245
246 For the second quarter of 2015, non-GAAP sales and marketing expense was \$80.7 million, or
247 28% of revenue, compared to \$56.3 million, or 26% of revenue in the second quarter of 2014,
248 as we continued to ramp our sales team and our brand and direct marketing activities. Included
249 in sales and marketing expense are commissions on subscriptions that we pay Google and
250 Apple totaling \$10.7 million, and \$10.2 million in brand, direct response and SEM activities. We
251 spent less than we had initially targeted and expect the bulk of the marketing spend for 2015 to
252 come in the second half of the year when our sales and marketing spend will be more cost
253 effective and, as listening hours increase, our ability to monetize the additional hours is at its
254 peak.

255
256 Non-GAAP product development expense was \$13.4 million for the second quarter, or 5% of
257 revenue, an increase of 55% compared to \$8.7 million in the second quarter of 2014. We often
258 say product development is an investment to drive revenue 13 to 36 months out, and thus we
259 are committed to increasing our spending in this critical area.

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261 Non-GAAP G&A expense was \$31.2 million or 11% of revenue, an increase of 53% compared to
262 \$20.5 million in the second quarter of 2014.

263

264 Turning to the balance sheet, Pandora ended the second quarter with \$461.5 million in cash
265 and investments compared to \$481.3 million at the end of the prior quarter. Cash used by
266 operating activities was \$9.9 million for the second quarter compared to cash used in operating
267 activities of \$7.1 million in the year-ago quarter. Capital expenditures were \$12.0 million in the
268 second quarter.

269

270 I'll wrap up with some thoughts regarding our guidance for the calendar year 2015 and the
271 third quarter 2015.

272

273 Starting with the full year 2015, we estimate total revenues in the range of \$1.175 billion to
274 \$1.185 billion, or year-over-year growth at the mid-point of approximately 30%, up \$5 million
275 on the top end and \$15 million on the bottom end from the prior range of \$1.16 billion to \$1.18
276 billion given on our Q1 earnings call. Continued momentum in advertising sales and confidence
277 in our sales strategy has allowed us to increase expectations for the year.

278

279 We expect calendar year 2015 adjusted EBITDA to be in the range of \$75 million to \$85 million,
280 or unchanged from the prior range. Adjusted EBITDA excludes forecasted stock-based
281 compensation expense of approximately \$112 million and forecasted depreciation and
282 amortization expense of approximately \$22 million and assumes minimal provision for income
283 taxes given our net loss position for 2015. Diluted shares outstanding for the full year 2015 are
284 expected to be approximately 221 million. Although we outperformed our EBITDA expectations
285 in the second quarter we are not raising our target for the year. The continued momentum in
286 advertising sales and audience engagement are indicators that we are poised to maintain and
287 extend leadership in mobile music streaming and ad-supported radio. Such an opportunity

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288 demands investment today to meet our long term objectives. And thus believe that increased
289 investments are appropriate for the second half of 2015.

290
291 For the third quarter of 2015, we expect total revenues in the range of \$310 million to \$315
292 million, crossing the \$300 million quarterly revenue milestone for the first time and achieving
293 year-over-year growth at the midpoint of 30%. Adjusted EBITDA is expected be in the range of
294 \$25 million to \$30 million for the third quarter. Adjusted EBITDA excludes forecasted stock-
295 based compensation expense of approximately \$30 million and forecasted depreciation and
296 amortization expense of approximately \$6 million and assumes minimal provision for income
297 taxes given our net loss position for the second quarter. Diluted shares outstanding for the third
298 quarter 2015 are expected to be approximately 222 million. We expect to ramp up marketing
299 investments in the third quarter to leverage improvements in monetization.

300
301 In summary, we had a very strong first half of the year. As a result we plan to continue to invest
302 in our business to fuel long-term growth. We are monetizing at an increased rate with RPMs
303 and revenue reaching all-time highs while investing in our strategies to expand and strengthen
304 our relationships with music makers, listeners and advertisers.

305
306 As a reminder, on Tuesday of this week, the months-long trial portion of the Copyright Royalty
307 Board's rate setting proceeding concluded with closing arguments. We presented a
308 comprehensive case with experts and witnesses, and are confident in the positions laid forth in
309 our filings and trial presentations to the CRB judges. We discussed the additive, promotional
310 value of Pandora, and demonstrated that we are a non-interactive service. We'll now wait until
311 later in the year to hear of the CRB's determination, but are already planning for a range of
312 scenarios, and are confident in Pandora's ability to deliver long-term growth no matter what
313 outcome the court decides. We believe there will be an economically rational outcome, and we
314 thank our business affairs team for their tireless, and thorough work during this process – as
315 anyone who observed would notice.

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317 And with that we're ready to take some questions. Operator?