



1 **Pandora (P) Q217 Financial Results Conference Call July 31, 2017**

2 **Scripts for:**

3 **Dominic Paschel, Vice President, Pandora**

4 **Naveen Chopra, CFO and Interim CEO**

5 **Karen Walker, Chief Accounting Officer**

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8 **July 31, 2017**

9 **Dominic Paschel**

10 Good afternoon, and welcome to Pandora's second quarter 2017 financial results call. Before we begin, let  
11 me remind everyone that today's discussion will contain forward-looking statements based on our current  
12 assumptions, expectations and beliefs, including projected financial results or operating metrics, business  
13 strategies, anticipated future products or services, anticipated market demand or opportunities and other  
14 forward-looking topics. For a discussion of the specific risk factors that could cause our actual results to  
15 differ materially from today's discussion, please refer to the documents we file with the Securities and  
16 Exchange Commission.

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18 Also, during this call, we will discuss non-GAAP measures of our performance. GAAP financial  
19 reconciliations and supplemental financial information are provided in the press release filed today with the  
20 SEC, and detailed financials are available on our Investor Relations site.

21

22 Today's call is available via webcast and a replay will be available for two weeks. We will also post the full  
23 text of today's prepared remarks once they have been concluded. You can find all of the information I have  
24 just described on the Investor Relations section of Pandora.com. With that, let me turn the call over to Naveen  
25 Chopra, Pandora's CFO and Interim CEO.

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27 **Naveen Chopra**

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29 **Refocused Company Strategy**

30 Thanks, Dom, and thank you to everyone for joining the call today. During the quarter, we've taken a  
31 number of steps to optimize Pandora's strategic position in order to capture our sizable market opportunity



32 and deliver maximum value to shareholders, listeners, partners and employees. Before we discuss second  
33 quarter operational results, let me outline what we've done from a strategic perspective:

- 34 • First, we announced changes to our board and management that are intended to bring new  
35 expertise and capabilities to our business. I'd like to take this opportunity to thank the prior  
36 team for their extensive contributions to Pandora and Tim Westergren in particular for his  
37 vision as our founder. Under Tim's watch, Pandora fundamentally changed how people  
38 listen to music and created a best-in-class product portfolio that serves many types of music  
39 listeners and greatly enhanced our relationships with the music industry.
- 40 • We also secured a major investment from SiriusXM, which will dramatically strengthen  
41 our balance sheet and bring valuable strategic insights to Pandora. As you know, Sirius's  
42 controlling shareholder, Liberty Media, has an impressive track record operating media  
43 businesses. Additionally, we see opportunity, as does Sirius, after the requisite government  
44 approval, to potentially up-sell, cross-sell and share content or technology.
- 45 • Furthermore, we decided to divest a non-core asset, Ticketfly, which will allow us to focus  
46 on our key advertising and subscription-based operations while exploring commercial  
47 relationships with a broader set of ticketing partners. Together with the proceeds from the  
48 Sirius investment, we believe that Pandora's financial future is secure with ample firepower  
49 to enable sustained, profitable growth.

50  
51 These changes present the opportunity to refine our strategic, operational, and financial objectives in light  
52 of evolving industry dynamics and changing consumer behavior. We have built a unique ecosystem at  
53 Pandora: a very large base of highly engaged listeners that power a compelling advertising business  
54 which has significant growth potential thanks to renewed focus on technology and innovation. In  
55 addition, we now have the ability to provide fully on-demand listening through our subscription products.  
56 These services help retain and grow listeners, in particular younger demographics, and enhance their  
57 engagement on our platform in a way that is highly accretive over the long-term. It is this ecosystem  
58 approach, that allows us to catalyze and benefit from changing consumer behavior - whether it be the  
59 continuing ability to capture listeners from terrestrial radio or the opportunity to engage listeners in the  
60 rapidly growing world of connected audio devices. And, we will have the financial resources to pursue  
61 these opportunities, among others, and in conjunction with our new partners at Sirius, drive value creation  
62 for all of our shareholders.



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With that backdrop, I'd now like to discuss second quarter results.

**Brief Overview of Q2 Financials**

From an operational perspective, Q2 was a solid quarter. We exceeded our revenue guidance thanks to better than expected advertising performance and Adjusted EBITDA came in above the midpoint of our guidance range. Karen Walker, our new Chief Accounting Officer will walk through our detailed results later in the call, but before she does so, I'd like to provide color on some key drivers of the business: Active Users, Advertising, and Subscriptions.

**Active Users**

For the quarter, Active Users were 76.0 million, representing a 2.7% decline year over year. We are encouraged that the year-over-year rate of decline in Q2 was lower than the 3.3% rate of decline we experienced in Q1. Additionally, the sequential decline of 1% we saw from Q1 to Q2 this year, was lower than the 1.7% decline we experienced from Q1 to Q2 in 2016. And, we're seeing stronger year-over-year engagement, with listeners tuning in an average 26 days per quarter, up 2% vs Q2 2016, and also representing an all-time high.

These improvements are a result of various initiatives we have implemented to retain and acquire listeners. During Q2, we adjusted on- and off-platform marketing efforts to refocus on audience growth versus subscription promotion - broadening the target audience and increasing our direct response spend - to drive new and lapsed users back to the Pandora ecosystem.

There is still more we can and intend to do to address the decline in active users. In the relatively near term, we believe that investment in science and technology that optimizes the listener experience via more personalized ad load and innovative ad formats, will help address the component of the active users impact that relates to increases in audio ad load. For example, further enhancing our insertion logic to deliver ads to the right listener at the right time, serving shorter length spots, and incorporating innovative ad products such as "sponsored listening," are all advancements that enable us to increase ad loads without negatively impacting ad-effectiveness or listener retention.



94 Longer term, active user growth is obviously a function of our ability to extend and evolve our products to  
95 meet the changing needs of consumers. To that end, we believe the combination of market trends, our  
96 product roadmap, and future marketing initiatives will allow us to materially bend the curve on active  
97 users.

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99 In particular, we are well-poised to capitalize on the huge growth being experienced in consumer  
100 electronic devices, including the trend toward voice-activation, and more connected automotive interfaces.  
101 In the quarter, we saw 9.7 million active users from consumer electronics alone, up 23% year-over-year,  
102 with 10% of those incremental CE listeners being new to the Pandora platform. Active users from voice-  
103 activated devices - a very natural platform for Pandora - accounted for 1.6M of those, up 282% year-over-  
104 year. In the back half of the year, we will deepen our existing relationships with partners like Amazon,  
105 Google and Sonos, while also adding new partnerships to expand our suite of over 2,000 connected  
106 devices.

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108 New additions in content, including an expansion of curated playlists, will also give listeners more reasons  
109 to come to Pandora. And we expect to continue to optimize our marketing and retention efforts with the  
110 help of new marketing automation technology.

111  
112 Meeting our ambitions with regard to user growth won't be an overnight endeavor, but now with key  
113 pieces in place, we are laser-focused, and well-equipped to grow active users which facilitates growth in  
114 our advertising business and the opportunity in subscription.

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116 **Advertising**

117 For the second quarter, advertising revenue grew approximately 5% year-over-year. Revenue growth was  
118 driven by shifting sales from lower-value channels to higher-value channels while simultaneously  
119 increasing ad loads. Specifically, average audio ad load increased -- from 3.3 to 5.3 spots per hour relative  
120 to the year-ago quarter and overall effective CPMs, meaning our blended realized CPM across all ad  
121 formats was consistent with the year-ago quarter and up substantially relative to Q1. CPMs for video and  
122 display were up year-over-year by 8% and 22%, respectively, and audio CPMs recovered nicely, up 26%  
123 relative to the most recent quarter. Our video advertising business continues on a strong trajectory, with  
124 revenue from sponsored listening video up 46% in the first half of 2017 vs 2016, while standard video  
125 revenue is up 16% in the same time period. Lastly, local advertising grew 15% year-over-year thanks to



126 the increased efficiency of our local sales teams. It's worth noting that this strong performance in  
127 advertising occurred during a quarter in which we were using more inventory than normal for house ads to  
128 support the launch of our subscription products. This quarter's results are also a great example of our  
129 ability to generate more value from our ad-supported audience even while listenership levels may not be  
130 growing.

131  
132 Going forward, we expect the trends in our advertising business to continue to improve. Our first half  
133 video momentum sets us up nicely for a successful launch of programmatic video and cost-per-view video  
134 products in Q3, and our launch of audio programmatic is expected to follow in Q4. Longer-term, we see  
135 significant opportunity to increase our share of ad dollars. The radio advertising market continues to be  
136 significant, at approximately \$15 to \$17 billion. And we see further opportunity to expand in local, not  
137 only by pulling from broadcast radio, but also from the larger total \$50 billion local advertising  
138 opportunity, as traditional channels such as local television and newspaper become digital. The shift in  
139 listening is evident; the proliferation of earbuds and the adoption of voice-activated devices are also  
140 reinvigorating the audio ad marketplace, one which we are very well-positioned to continue to dominate.

### 143 **Subscription**

144 Q2 marked the full launch of Pandora Premium with the introduction of our marketing campaign in mid-  
145 April. Although it is still early days, Premium fills an important need in our product portfolio, and we are  
146 encouraged by the high engagement of Premium listeners. On average, hours per listener increases by  
147 43% when a user upgrades from our ad-supported service to Pandora Premium. And both of our  
148 subscription products, Plus and Premium, over-index with listeners under the age of 25 with the  
149 proportion of new subscribers in this age group growing 72% relative to the same time period in 2016,  
150 demonstrating their interest in on-demand product features.

151  
152 We began converting subscribers from trials in mid-May and ended the quarter with approximately  
153 390,000 Premium subscribers. Q2 total subs grew by 150,000, to 4.86 million subs, due to the fact that a  
154 material number of would-be Plus subscribers entered trials for the Premium tier during the quarter. We  
155 expected that this dynamic would exist during the early phases of Premium. Overall, 64% of our Premium  
156 subscriptions came from our ad-supported tier, and we expect the free-tier will continue to be our primary  
157 source of subscribers going forward.



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159 As we progress through the year, we will continue to enhance our premium product and optimize our  
160 marketing efforts. We expect to launch new distribution partners, new billing options, and subscriber  
161 retention programs. Our primary goal with Pandora Premium is to ensure that we keep consumers who  
162 seek fully-interactive listening within the Pandora ecosystem. Our marketing approach reflects this goal as  
163 we are now focusing our off-platform promotional efforts on acquiring active users for the ad-supported  
164 service and then utilizing a variety of on-platform tools to determine which tier of service will be most  
165 "sticky" for any given listener. This model ensures that we are first growing a healthy advertising-  
166 supported base of listeners and then layering on subscription "upside" which, by the way, can be done in  
167 an economically sound manner due to the low costs of acquisition associated with moving a listener from  
168 a free to paid tier. To be clear, we continue to believe that a compelling on-demand product is critical to  
169 maintaining and growing our total audience. Without such capabilities, we would risk decline of our user  
170 base.

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172 With that color on some of the key components of the business, I will now turn it over to Karen who will  
173 walk through some details on the quarterly results.

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177 **Karen Walker**

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179 **Second Quarter Performance**

180 Thanks Naveen. I'm very excited to be here. I have been a loyal listener and long admirer of the Pandora  
181 brand and the unique and powerful listening experience it provides its users. I joined Pandora because I  
182 believe that we have superior products and the right strategy to capitalize on the huge opportunity in front  
183 of us. I look forward to working with you and the team to help execute the Company's strategy.

184

185 Now onto second quarter results. Total revenue for the second quarter was \$376.8 million, above the high  
186 end of our guidance. Advertising revenue was \$278.2 million, compared to \$265.1 million in the year-ago  
187 quarter growing 5% year-over-year.

188



189 Ad RPM grew 24% year-over-year to \$66.15, which is a second quarter record, and our second best  
190 quarterly ad RPM ever.

191

192 Subscription and other revenue was \$68.9 million, an increase of 25% over the same period in 2016. Net  
193 subscribers increased 24% year-over-year to 4.86 million. Subscription ARPU was \$4.82 up from \$4.76 in  
194 the prior quarter, reflecting a shift from Pandora Plus to Premium. Subscription ARPU was \$4.82 in Q2,  
195 up from \$4.63 from a year ago. We expect to see some fluctuation in the rate of subscriber growth as users  
196 come on and off trial subscriptions, and we continue to remain excited about the Pandora Plus and  
197 Premium opportunities, as outlined by Naveen earlier.

198

### 199 **Content Costs**

200 Ad-related content costs represented 54% of advertising revenue in Q2. For the quarter, ad LPM was  
201 \$35.84, an increase of 17% compared to the same quarter last year and an increase of 7% from Q1.

202 Relative to the year-ago period, the ad LPM increase reflects the impact of direct deals. Subscription-  
203 related content costs represented 66% of subscription revenue in Q2. For the quarter, licensing cost per  
204 subscriber (or LPU), was \$3.11, an increase of 5% from Q1. The increase in ad LPM and subscription  
205 LPU relative to Q1 relates to accruals for certain minimum guarantees and changes in our expectations  
206 regarding total subscriber counts and the point in time at which volume discounts are likely to kick-in. We  
207 expect content costs to remain above optimized levels until certain subscription thresholds are met.

208

### 209 **Gross Margin**

210 Non-GAAP gross margin was 36%, compared to 38% in the year-ago quarter. The decline in margin year-  
211 over-year was primarily driven by higher statutory rates under direct-deals versus statutory rates.

212

### 213 **Q2 Operating Expenses**

214 Turning to operating expenses, for the second quarter of 2017, non-GAAP sales and marketing expense  
215 was \$126.6 million, an increase of 20% compared to the second quarter of 2016. The majority of the  
216 increase was driven by direct marketing spend for the Premium product launch and brand advertising  
217 campaigns, as previewed last quarter. We expect the full-year sales and marketing expense for 2017 to be  
218 relatively flat to 2016.

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220 Non-GAAP product development expense was \$31.5 million for the second quarter, an increase of 29%  
221 compared to the second quarter of 2016, primarily driven by an increase in average headcount and lower  
222 capitalized personnel costs following the launch of Pandora Premium. R&D expense is expected to  
223 remain relatively flat through the end of the year. We continue to believe that product and service  
224 innovation is at the core of our value proposition for both advertisers and consumers, and we intend to  
225 continue to prioritize product development investments going forward.

226

227 Non-GAAP G&A expense was \$44.4 million, an increase of 38% compared to the second quarter of 2016,  
228 primarily driven by a number of one-time items, including a \$6.6 million charge related to the bankruptcy  
229 of a large Ticketfly client, the Pemberton Music Festival. Non-GAAP G&A also included legal fees of  
230 \$3.8 million related to the rate-setting proceedings under Section 115 of the DMCA, which occur every  
231 five years. We expect G&A as a percentage of revenue, as well as absolute dollars, to decline for the  
232 remainder of the year.

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#### 234 **Adjusted EBITDA**

235 Adjusted EBITDA for the second quarter was a loss of \$54.3 million exceeding the midpoint of our  
236 guidance range. Had it not been for the previously mentioned bad debt expense for Pemberton, we would  
237 have exceeded the high end of our guidance by a significant margin. Q2 Adjusted EBITDA loss was  
238 \$29.2 million higher than the same period a year ago, primarily due to the increases I described earlier in  
239 both sales and marketing and G&A. As Naveen mentioned, we will continue to carefully manage  
240 headcount with a focus on the bottom line, while focusing our hiring in high-priority areas. The detailed  
241 reconciliation of Adjusted EBITDA to Net Loss is provided in our press release.

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#### 243 **EPS**

244 Second quarter 2017 GAAP basic and diluted net loss per share was \$1.20. Non-GAAP basic and diluted  
245 net loss per share was \$0.21. GAAP and non-GAAP basic and diluted EPS were based on 241.3 million  
246 weighted average common shares outstanding.

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#### 248 **Cash**

249 Pandora ended the second quarter with \$227.6 million in cash and investments compared to \$203.0  
250 million at the end of the prior quarter. Cash used in operating activities was \$103.5 million for the second





251 quarter and included a number of one-time items such as \$23.5 million of fees related to the KKR contract  
252 and its termination, and \$6.6 million related to the bankruptcy of the Pemberton Music Festival. Cash of  
253 \$25.6 million for the Ticketfly segment was reclassified as held for sale on our balance sheet along with  
254 the total Ticketfly net assets.

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### 256 **Transaction-Related Activities**

257 During the quarter, we initiated several significant non-routine transactions which I'll outline briefly and  
258 explain the expected impact of the transactions on 2017 financials:

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260 We executed an investment agreement with Sirius XM, which will allow Sirius to purchase an aggregate  
261 of \$480.0 million of newly issued Series A preferred stock. The preferred stock has a \$1,000 liquidation  
262 preference per share convertible into common shares at \$10.50 per share. The investment occurs in two  
263 stages: the first closed on June 9th and the second will close following regulatory approval, which we  
264 expect to occur in Q4. Total proceeds net of transaction fees from the initial closing were \$158.6 million.

265

266 Also during the quarter, we agreed to sell Ticketfly to Eventbrite for \$200 million, which consists of \$150  
267 million in cash and a \$50 million convertible note receivable, which we expect to close in the back half of  
268 August.

269

270 On June 27, we announced a plan to discontinue our New Zealand and Australia operations and incurred  
271 related restructuring charges, the details of which are included in our 10-Q filing. We are currently  
272 winding down the service and beginning in Q3, active users and listener hours from Australia / New  
273 Zealand will no longer be included in our total active users and listener hours numbers. For the end of the  
274 year, we would have expected 1.3 million active users from the region.

275

276 As a result of these activities, we expect a \$50-55 million reduction to 2017 revenue. In terms of EBITDA,  
277 we don't expect a significant impact given that Ticketfly was operating at near break even, and Australia  
278 & New Zealand's contributions were not material.

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280 With that, let me hand the call back to Naveen to discuss guidance.

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284 **Naveen Chopra**

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286 Thank you, Karen.

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288 **Guidance**

289 Before providing our estimates for Q3, I'd like to walk through adjustments to our existing full-year  
290 guidance to reflect the changes we announced with Ticketfly and Australia / New Zealand. On our prior  
291 call, we guided to an annual revenue range of \$1.50 to \$1.65 Billion. As previously noted, Ticketfly and  
292 ANZ represented \$50-\$55M of revenue between the anticipated close dates and the end of the fiscal year.  
293 So, incorporating the Ticketfly sale and the shutdown of Australia / New Zealand would imply that our  
294 previously issued annual guidance was effectively \$1.45 to \$1.60 billion. With the completion of Q2, we  
295 are now able to narrow our 2017 revenue expectations to \$1.45 to \$1.50 billion. We are lowering the top  
296 end of the guidance range to reflect the fact that we are prioritizing the growth and retention of active  
297 users rather than aggressively pushing all users to subscriptions. As a result, our expectations for  
298 subscriber growth during 2017 have been revised. As I noted earlier, we believe this approach will  
299 optimize the overall health and value of our business. Average basic shares outstanding for calendar year  
300 2017 are expected to be approximately 243 million. We are currently forecasting a non-GAAP effective  
301 tax rate of approximately 32% to 37% for the full year 2017. However, the Company is not expected to  
302 incur any material cash taxes due to its net operating loss position.

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304 For Q3, we expect revenue in the range of \$370 to \$385 million, reflecting a 14% year-over-year growth  
305 rate at the midpoint, when adjusting for the divestiture of Ticketfly. As a reminder, Q3 revenue guidance  
306 assumes only two months of sales from Ticketfly. Adjusted EBITDA is expected in the range of a \$20  
307 million loss to a \$5 million loss. Adjusted EBITDA differs from GAAP net loss in that it excludes  
308 forecasted stock-based compensation expense of approximately \$32 million, depreciation and  
309 amortization expense of approximately \$15 million, other expense of \$7 million and a provision for  
310 income taxes of approximately \$0.4 million and assumes minimal cash taxes given our net loss position.  
311 Basic shares outstanding for the third quarter of 2017 are expected to be approximately 245 million.

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313

314 **In Summary**

315 In closing, I hope you recognize our renewed focus on two key priorities: (1) growing our overall base of  
316 listeners, and (2) continuing to improve monetization of those users. We now have the critical pieces in  
317 place to pursue these goals, including:

- 318 • A core advertising business which remains the largest publisher of digital audio advertising in  
319 the US and which has significant room to grow both its audience and its ability to monetize  
320 that audience;
- 321 • A subscription business that improves our ability to engage younger listeners and retain those  
322 consumers who seek on-demand listening capabilities;
- 323 • A strong balance sheet that provides flexibility to operate and invest in ways that continue to  
324 drive scale and enhance shareholder value;
- 325 • A strong operating team and new board members with a successful track-record operating  
326 pioneering media businesses, similar to Pandora;
- 327 • And, we continue to enjoy relationships with the music industry that are stronger than ever,  
328 assuring the delivery of content to attract and engage listeners.

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330 We look forward to updating you on our progress in all of these areas on our next call.

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332 And now I'll turn the call to the operator, who will open the line for your questions. Operator?

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