# Section 1: 10-Q (10-Q)

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended March 31, 2014**

**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**<br>(State or other jurisdiction of incorporation or organization) | **94-3352630**<br>(I.R.S. Employer Identification No.) |
| **2101 Webster Street, Suite 1650**<br>**Oakland, CA**<br>(Address of principal executive offices) | **94612**<br>(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 ☐<br>(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 April 24, 2014 was: 205,451,005.



**Pandora Media, Inc.**

**FORM 10-Q Quarterly Report**

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**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, 2013 | | As of March 31, 2014 |
|---|---|---|---|---|
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 245,755 | $ | 160,796 |
| Short-term investments | | 98,662 | | 180,496 |
| Accounts receivable, net of allowance of $1,272 at December 31, 2013 and $1,194 at March 31, 2014 | | 164,023 | | 148,320 |
| Prepaid expenses and other current assets | | 10,343 | | 15,481 |
| Total current assets | | 518,783 | | 505,093 |
| Long-term investments | | 105,686 | | 104,569 |
| Property and equipment, net | | 35,151 | | 38,697 |
| Other long-term assets | | 13,715 | | 13,860 |
| Total assets | $ | 673,335 | $ | 662,219 |
| Liabilities and stockholders' equity | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | 14,413 | $ | 10,087 |
| Accrued liabilities | | 14,885 | | 14,810 |
| Accrued royalties | | 66,110 | | 74,698 |
| Deferred revenue | | 42,650 | | 28,123 |
| Accrued compensation | | 17,948 | | 18,043 |
| Total current liabilities | | 156,006 | | 145,761 |
| Other long-term liabilities | | 9,098 | | 9,826 |
| Total liabilities | | 165,104 | | 155,587 |
| Stockholders' equity: | | | | |
| Common stock: 195,395,940 shares issued and outstanding at December 31, 2013 and 205,237,705 at March 31, 2014 | | 20 | | 21 |
| Additional paid-in capital | | 675,103 | | 702,301 |
| Accumulated deficit | | (166,591) | | (195,522) |
| Accumulated other comprehensive loss | | (301) | | (168) |
| Total stockholders' equity | | 508,231 | | 506,632 |
| Total liabilities and stockholders' equity | $ | 673,335 | $ | 662,219 |

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 March 31, | | | |
|---|---|---|---|---|
| | | 2013 (recast) | | 2014 |
| Revenue | | | | |
| Advertising | $ | 96,714 | $ | 140,634 |
| Subscription and other | | 18,410 | | 53,681 |
| Total revenue | | 115,124 | | 194,315 |
| Cost of revenue | | | | |
| Cost of revenue - Content acquisition costs | | 85,823 | | 108,275 |
| Cost of revenue - Other | | 9,776 | | 14,979 |
| Total cost of revenue | | 95,599 | | 123,254 |
| Gross profit | | 19,525 | | 71,061 |
| Operating expenses | | | | |
| Product development | | 6,667 | | 11,831 |
| Sales and marketing | | 38,045 | | 61,864 |
| General and administrative | | 13,355 | | 26,361 |
| Total operating expenses | | 58,067 | | 100,056 |
| Loss from operations | | (38,542) | | (28,995) |
| Other income (expense) | | | | |
| Interest income | | 16 | | 218 |
| Interest expense | | (144) | | (129) |
| Other income (expense), net | | 1 | | 3 |
| Loss before provision for income taxes | | (38,669) | | (28,903) |

| | | |
|---|---|---|
| Income tax expense | (17) | (28) |
| Net loss | $ (38,686) | $ (28,931) |
| Weighted-average common shares outstanding used in computing basic and diluted net loss per share | 172,733 | 199,857 |
| Net loss per share, basic and diluted | $ (0.22) | $ (0.14) |

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 March 31, | |
|---|---|---|
| | **2013** | **2014** |
| | **(recast)** | |
| Net loss | $ (38,686) | $ (28,931) |
| Change in foreign currency translation adjustment | (4) | 19 |
| Change in net unrealized losses on marketable securities | 3 | 114 |
| Other comprehensive loss | (1) | 133 |
| Total comprehensive loss | $ (38,687) | $ (28,798) |

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)**

| | Three months ended March 31, | |
|---|---|---|
| | **2013** | **2014** |
| | **(recast)** | |
| Operating activities | | |
| Net loss | $ (38,686) | $ (28,931) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation and amortization | 2,034 | 3,346 |
| Stock-based compensation | 6,524 | 17,392 |
| Amortization of premium on investments | 60 | 694 |
| Amortization of debt issuance costs | 66 | 49 |
| Changes in assets and liabilities | | |
| Accounts receivable | 3,647 | 15,703 |
| Prepaid expenses and other assets | (1,143) | (5,212) |
| Accounts payable and accrued liabilities | 1,911 | 1,401 |
| Accrued royalties | 9,353 | 8,585 |
| Accrued compensation | (4,065) | (735) |
| Deferred revenue | 7,422 | (14,527) |
| Net cash used in operating activities | (12,877) | (2,235) |
| Investing activities | | |
| Purchases of property and equipment | (4,318) | (11,774) |
| Purchases of investments | (13,365) | (115,589) |
| Proceeds from maturities of investments | 18,830 | 34,010 |
| Net cash provided by (used in) investing activities | 1,147 | (93,353) |
| Financing activities | | |
| Proceeds from employee stock purchase plan | — | 863 |
| Proceeds from issuance of common stock | 4,033 | 9,751 |
| Net cash provided by financing activities | 4,033 | 10,614 |
| Effect of exchange rate changes on cash and cash equivalents | (6) | 15 |
| Net decrease in cash and cash equivalents | (7,703) | (84,959) |

| | | |
|---|---|---|
| Cash and cash equivalents at beginning of period | 59,939 | 245,755 |
| Cash and cash equivalents at end of period | $ 52,236 | $ 160,796 |

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





**Pandora Media, Inc.**

**Notes to Condensed Consolidated Financial Statements**

## 1. Description of Business and Basis of Presentation

Pandora Media, Inc. provides an internet radio service offering a personalized experience for each listener wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. 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. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. We also offer a paid subscription service which we call Pandora One. We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010.

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”) 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 Transition Report on Form 10-K for the eleven months ended December 31, 2013.

We changed our fiscal year from the twelve months ending January 31 to the calendar twelve months ending December 31, effective beginning with the year ended December 31, 2013. As a result of this change, our prior fiscal year was an 11-month transition period ended on December 31, 2013. All references herein to a fiscal year refer to the twelve months ended December 31 of such year, and references to the first, second, third and fourth fiscal quarters refer to the three months ended March 31, June 30, September 30 and December 31, respectively. Prior year results have been recast on a calendar quarter basis. Refer to our Transition Report on Form 10-K for the eleven months ended December 31, 2013 for additional information regarding our fiscal year change.

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. Our statements of operations now include the presentation of gross profit, which is calculated as total revenue less cost of revenue. In addition, we have reclassified certain software license fees, facilities-related expenses and depreciation expenses among the general and administrative, cost of revenue — other, sales and marketing and product development lines in 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 for determining accrued royalties, selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, stock-based compensation, income taxes and the subscription return reserve. To the extent there are material differences between these estimates, judgments, 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.





**Pandora Media, Inc.**

**Notes to Condensed Consolidated Financial Statements - Continued**

## 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 Transition Report on Form 10-K for the eleven months ended December 31, 2013.

*Stock-Based Compensation — Employee Stock Purchase Plan*

In December 2013, our board of directors approved the Employee Stock Purchase Plan ("ESPP"), subject to approval at the annual meeting of stockholders in June 2014. We estimate the fair value of shares to be issued under the ESPP on the first day of the offering period using the Black-Scholes valuation model. The determination of the fair value is affected by our stock price on the first date of the offering period, as well as other assumptions including the risk-free interest rate, the estimated volatility of our stock price over the term of the offering period, the expected term of the offering period and the expected dividend rate. Stock-based compensation expense related to the ESPP is recognized on a straight-line basis over the offering period, net of estimated forfeitures. If the stockholders do not approve the ESPP, the ESPP will be terminated, any contributions will be returned to the participants and we will reverse the accumulation of the expense related to the ESPP at that time.

*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.

In addition, subscription revenue derived from sales through certain mobile devices 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 return reserve.

We were required to defer revenue for certain in application ("in-app") mobile subscriptions that contained refund rights until the refund rights lapsed or we developed sufficient operating history to estimate a return reserve. As of December 31, 2013, we had deferred all revenue related to these in-app mobile subscriptions subject to refund rights totaling approximately $14.2 million, as we did not have sufficient history to estimate a return reserve. Beginning in January 2014, we had sufficient historic transactional information which enabled us to estimate future returns. Accordingly, in January 2014, we began recording revenue related to these in-app mobile subscriptions net of estimated returns. This change resulted in a one-time increase in subscription revenue in the three months ended March 31, 2014 of approximately $14.2 million, as the previously deferred revenue was recognized. As of March 31, 2014, the deferred revenue related to the return reserve was not significant.

*Concentration of Credit Risk*

For the three months ended March 31, 2013 and 2014, we had no customers that accounted for more than 10% of our total revenue. As of December 31, 2013 and March 31, 2014, we had no customers that accounted for more than 10% of our total accounts receivable.



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## 3. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments consisted of the following:

| | As of December 31, 2013 | As of March 31, 2014 |
|---|---|---|
| | (in thousands) | |
| Cash and cash equivalents: | | |
| Cash | $ 89,176 | $ 60,096 |
| Money market funds | 98,437 | 90,531 |
| Commercial paper | 54,247 | 4,000 |
| Corporate debt securities | 3,895 | 6,169 |
| Total cash and cash equivalents | $ 245,755 | $ 160,796 |
| Short-term investments: | | |
| Commercial paper | $ 47,526 | $ 78,424 |
| Corporate debt securities | 50,436 | 101,372 |
| U.S. government and government agency debt securities | 700 | 700 |
| Total short-term investments | $ 98,662 | $ 180,496 |
| Long-term investments: | | |
| Corporate debt securities | $ 100,690 | $ 94,328 |
| U.S. government and government agency debt securities | 4,996 | 10,241 |
| Total long-term investments | $ 105,686 | $ 104,569 |
| Cash, cash equivalents and investments | $ 450,103 | $ 445,861 |

Our short-term investments have maturities of less than twelve months 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, 2013 and March 31, 2014.

| | As of December 31, 2013 | | | |
|---|---|---|---|---|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| | (in thousands) | | | |
| Money market funds | $ 98,437 | $ — | $ — | $ 98,437 |
| Commercial paper | 101,773 | — | — | 101,773 |
| Corporate debt securities | 155,273 | 6 | (258) | 155,021 |
| U.S. government and government agency debt securities | 5,700 | — | (4) | 5,696 |
| Total cash equivalents and marketable securities | $ 361,183 | $ 6 | $ (262) | $ 360,927 |



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| | As of March 31, 2014 | | | |
|---|---|---|---|---|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| | (in thousands) | | | |
| Money market funds | $ 90,531 | $ — | $ — | $ 90,531 |
| Commercial paper | 82,424 | — | — | 82,424 |
| Corporate debt securities | 202,000 | 28 | (159) | 201,869 |
| U.S. government and government agency debt securities | 10,952 | — | (11) | 10,941 |
| Total cash equivalents and marketable securities | $ 385,907 | $ 28 | $ (170) | $ 385,765 |

The following table presents available-for-sale investments by contractual maturity date as of December 31, 2013 and March 31, 2014.

| | As of December 31, 2013 | |
|---|---|---|
| | Adjusted Cost | Fair Value |
| | (in thousands) | |
| Due in one year or less | $ 255,278 | $ 255,241 |
| Due after one year through three years | 105,905 | 105,686 |
| Total | $ 361,183 | $ 360,927 |

| | As of March 31, 2014 | |
|---|---|---|
| | Adjusted Cost | Fair Value |
| | (in thousands) | |
| Due in one year or less | $ 281,237 | $ 281,196 |
| Due after one year through three years | 104,670 | 104,569 |
| Total | $ 385,907 | $ 385,765 |

Our 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 and rated "A" by Standard & Poor's or "A2" by Moody's or better for long-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.

The unrealized losses on our available-for-sale securities as of March 31, 2014 were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of March 31, 2014, we owned 89 securities that were in an unrealized loss position. We do not intend nor expect to need to sell these securities before recovering the associated unrealized losses. We expect to recover the full carrying value of these securities. As a result, no portion of the unrealized losses at March 31, 2014 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 twelve months or more. When evaluating the investments for other-than-temporary impairment, we review 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 our intent to sell, or whether it is more likely than not we will be required to sell, the investment before recovery of the investment's amortized cost basis. During the three months ended March 31, 2014, we did not recognize any impairment charges.



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4. **Fair Value**

We record 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.

When determining fair value, whenever possible we use observable market data and rely 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 December 31, 2013 and March 31, 2014:

| | As of December 31, 2013 Fair Value Measurement Using | | |
|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Instruments (Level 1) | Significant Other Observable Inputs (Level 2) | Total |
| | | (in thousands) | |
| Assets: | | | |
| Money market funds | $ 98,437 | $ — | $ 98,437 |
| Commercial paper | — | 101,773 | 101,773 |
| Corporate debt securities | — | 155,021 | 155,021 |
| U.S. government and government agency debt securities | — | 5,696 | 5,696 |
| Total assets measured at fair value | $ 98,437 | $ 262,490 | $ 360,927 |

| | As of March 31, 2014 Fair Value Measurement Using | |
|---|---|---|
| | Quoted Prices in Active Markets for Identical Instruments | Significant Other Observable Inputs |