Pandora Media, Inc.
Form 10-Q
November 27, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 31, 2013

or

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

For the transition period from to

Commission File Number: 001-35198

Pandora Media, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**94-3352630** (I.R.S. Employer Identification No.)
2101 Webster Street, Suite 1650 **Oakland, CA** (Address of principal executive offices)	**94612** (Zip Code)

(510) 451-4100

(Registrant s telephone number, including area code)

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

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 x No o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of registrant s common stock outstanding as of November 21, 2013 was: 194,254,664.

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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 January 31, 2013		As of October 31, 2013
Assets				
Current assets:				
Cash and cash equivalents	$	65,725	$	442,380
Short-term investments		23,247		5,449
Accounts receivable, net of allowance of $761 at January 31, 2013 and $1,285 at October 31, 2013		103,410		141,796
Prepaid expenses and other current assets		6,232		10,240
Total current assets		198,614		599,865
Property and equipment, net		17,758		27,768
Other long-term assets		2,460		10,053
Total assets	$	218,832	$	637,686
Liabilities and stockholders equity				
Current liabilities:				
Accounts payable	$	4,471	$	7,526
Accrued liabilities		7,590		16,747
Accrued royalties		53,083		58,499
Deferred revenue		29,266		43,088
Accrued compensation		21,560		18,037
Total current liabilities		115,970		143,897
Other long-term liabilities		3,873		8,239
Total liabilities		119,843		152,136
Stockholders equity:				
Common stock, $0.0001 par value, 1,000,000,000 shares authorized: 172,506,051 shares issued and outstanding at January 31, 2013 and 194,067,320 at October 31, 2013		17		19
Additional paid-in capital		238,552		663,212
Accumulated deficit		(139,574)		(177,648)
Accumulated other comprehensive loss		(6)		(33)
Total stockholders equity		98,989		485,550
Total liabilities and stockholders equity	$	218,832	$	637,686

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 October 31, 2012	Three months ended October 31, 2013	Nine months ended October 31, 2012	Nine months ended October 31, 2013
Revenue				
Advertising	$ 106,258	$ 144,346	$ 266,239	$ 378,012
Subscription services and other	13,747	36,030	35,817	85,229
Total revenue	120,005	180,376	302,056	463,241
Costs and expenses				
Cost of revenue - Content acquisition costs	65,713	86,989	182,053	251,722
Cost of revenue Other	8,338	12,423	22,769	33,239
Product development	4,371	8,848	12,965	23,807
Sales and marketing	26,714	50,575	73,631	136,452
General and administrative	12,700	23,038	33,914	55,599
Total costs and expenses	117,836	181,873	325,332	500,819
Income (loss) from operations	2,169	(1,497)	(23,276)	(37,578)
Other income (expense)				
Interest income	19	5	76	30
Interest expense	(137)	(167)	(397)	(460)
Other income (expense), net	1	(21)	1	(16)
Income (loss) before provision for income taxes	2,052	(1,680)	(23,596)	(38,024)
Income tax benefit (expense)		(20)	5	(50)
Net income (loss)	$ 2,052	$ (1,700)	$ (23,591)	$ (38,074)
Basic net income (loss) per share	$ 0.01	$ (0.01)	$ (0.14)	$ (0.21)
Weighted-average shares used in computing basic per share amounts	169,391	184,676	167,423	177,913
Diluted net income (loss) per share	$ 0.01	$ (0.01)	$ (0.14)	$ (0.21)
Weighted-average shares used in computing diluted per share amounts	190,278	184,676	167,423	177,913

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 Income (Loss)

(In thousands)

(Unaudited)

	Three months ended October 31,		Nine months ended October 31,	
	2012	**2013**	**2012**	**2013**
Net income (loss)	$ 2,052	$ (1,700)	$ (23,591)	$ (38,074)
Change in foreign currency translation adjustment	(1)	20	(1)	(30)
Change in net unrealized losses on marketable securities	(2)		1	3
Other comprehensive income (loss)	(3)	20		(27)
Total comprehensive income (loss)	$ 2,049	$ (1,680)	$ (23,591)	$ (38,101)

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 October 31, 2012	Nine months ended October 31, 2013
Operating activities		
Net loss	$ (23,591)	$ (38,074)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	5,147	8,171
Loss on disposition of assets	23	
Stock-based compensation	18,610	30,570
Amortization of premium on investments	279	57
Amortization of debt issuance costs	198	187
Changes in assets and liabilities		
Accounts receivable	(31,126)	(38,386)
Prepaid expenses and other assets	(2,036)	(4,715)
Accounts payable and accrued liabilities	4,532	13,909
Accrued royalties	10,608	5,416
Accrued compensation	(243)	(3,319)
Deferred revenue	7,744	13,822
Reimbursement of cost of leasehold improvements	1,243	1,555
Net cash used in operating activities	(8,612)	(10,807)
Investing activities		
Purchases of property and equipment	(5,981)	(14,891)
Purchases of patents		(8,000)
Purchases of short-term investments	(50,124)	(20,426)
Proceeds from maturities of short-term investments	73,460	38,160
Payments related to acquisition		(400)
Net cash provided by (used in) investing activities	17,355	(5,557)
Financing activities		
Borrowings under debt arrangements		10,000
Repayments of debt		(10,000)
Proceeds from follow-on offering, net of issuance costs		379,088
Proceeds from issuance of common stock	5,065	14,884
Tax withholdings related to net share settlements of restricted stock units	(208)	(480)
Payment of debt issuance costs in connection with the debt refinancing		(450)
Net cash provided by financing activities	4,857	393,042
Effect of exchange rate changes on cash and cash equivalents	(1)	(23)
Net increase in cash and cash equivalents	13,599	376,655
Cash and cash equivalents at beginning of period	44,126	65,725
Cash and cash equivalents at end of period	$ 57,725	$ 442,380

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

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 Annual Report on Form 10-K for the fiscal year ended January 31, 2013.

Follow-on Public Offering

In September 2013, we completed a follow-on public offering in which we sold an aggregate of 15,730,000 shares of our common stock, inclusive of 2,730,000 shares sold pursuant to the exercise by the underwriters of an option to purchase additional shares, at a public offering price of $25.00 per share. In addition, another 5,200,000 shares were sold by certain selling stockholders. We received aggregate net proceeds of $379.1 million, after deducting underwriting discounts and commissions and offering expenses from sales of our shares in the offering. We did not receive any of the proceeds from the sales of shares by the selling stockholders.

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 and income taxes. 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.

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Fiscal Year

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

We have announced that we will convert our fiscal year to the calendar twelve months ending December 31 to align with the advertising industry s business cycle, effective beginning with the year ending December 31, 2013. As a result, our current fiscal year will be shortened from twelve months to an eleven month transition period that will end on December 31, 2013. As such, we are reporting our third fiscal quarter as the three months ending October 31, 2013, followed by a two month transition period ending December 31, 2013.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

2. Summary of Significant Accounting Policies

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 fiscal year ended January 31, 2013.

Concentration of Credit Risk

For the three and nine months ended October 31, 2012 and 2013, we had no customers that accounted for more than 10% of our total revenue.

As of January 31 and October 31, 2013, we had no customers that accounted for more than 10% of our total accounts receivable.

Recently Issued Accounting Standards

In July 2013, the FASB issued an update to provide guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward exists. The guidance requires an entity to present an unrecognized tax benefit in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, except for when a net operating loss carryforward is not available as of the reporting date to settle taxes that would result from the disallowance of the tax position or when the entity does not intend to use the deferred tax asset for purposes of reducing the net operating loss carryforward. The guidance is effective for fiscal years beginning after December 15, 2013 and for interim periods within that fiscal year. We do not expect the adoption of this guidance to have a material effect on the consolidated balance sheets.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

3. Cash, Cash Equivalents and Short-term Investments

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

		As of January 31, 2013		As of October 31, 2013
		(in thousands)		
Cash and cash equivalents:				
Cash	$	22,703	$	414,912
Money market funds		32,522		27,468
Commercial paper		10,500		
Corporate debt securities				
Total cash and cash equivalents	$	65,725	$	442,380
Short-term investments:				
Commercial paper	$	13,592	$	4,749
Corporate debt securities		9,655		700
Total short-term investments	$	23,247	$	5,449
Cash, cash equivalents and short-term investments	$	88,972	$	447,829

Our short-term investments have maturities of less 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 January 31 and October 31, 2013.

	As of January 31, 2013 (in thousands)							
		Adjusted Cost		Unrealized Gains		Unrealized Losses		Fair Value
Money market funds	$	32,522	$		$		$	32,522
Commercial paper		24,093				(1)		24,092
Corporate debt securities		9,657				(2)		9,655
Total cash equivalents and marketable securities	$	66,272	$		$	(3)	$	66,269

	As of October 31, 2013 (in thousands)			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$ 27,468	$	$	$ 27,468
Commercial paper	4,749			4,749
Corporate debt securities	700			700
Total cash equivalents and marketable securities	$ 32,917	$	$	$ 32,917

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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, 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 January 31, 2013 were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of October 31, 2013, we did not own any securities that were in an unrealized loss position. During the three and nine months ended October 31, 2013, we did not recognize any impairment charges.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

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. As of January 31 and October 31, 2013 we did not hold any Level 3 assets.

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 January 31 and October 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)	
Fair values as of January 31, 2013			
Assets:			

Money market funds	$	32,522	$		$	32,522
Commercial paper				24,092		24,092
Corporate debt securities				9,655		9,655
Total assets measured at fair value	$	32,522	$	33,747	$	66,269
Fair values as of October 31, 2013						
Assets:						
Money market funds	$	27,468	$		$	27,468
Commercial paper				4,749		4,749
Corporate debt securities				700		700
Total assets measured at fair value	$	27,468	$	5,449	$	32,917

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

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

5. Commitments and Contingencies

Legal Proceedings

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

In June 2011, a putative class action lawsuit was filed against Pandora in the United States District Court for the Northern District of California alleging that we unlawfully accessed and transmitted personally identifiable information of the plaintiffs in connection with their use of our Android mobile application. In addition to civil liability, the amended complaint includes allegations of violations of statutes under which criminal penalties could be imposed if we were found liable. Our motion to dismiss the first amended complaint was granted on March 26, 2013. The court allowed the plaintiff to amend his complaint. The second amended complaint, filed May 9, 2013, contains allegations similar to those contained in the previous complaint. Our motion to dismiss the second amended complaint was filed May 30, 2013. The court has not yet ruled on the motion.

In September 2011, a putative class action lawsuit was filed against Pandora in the United States District Court for the Northern District of California alleging that we violated Michigan s video rental privacy law and consumer protection statute by allowing our listeners listening history to be visible to the public. Our motion to dismiss the complaint was granted on September 28, 2012, judgment was entered on November 14, 2012. The plaintiff appealed the judgment to the U.S. Court of Appeals for the Ninth Circuit. Briefing of the appeal was completed on August 2, 2013. No date has been set for oral argument.

On September 10, 2012, B.E. Technology, LLC filed suit against Pandora in the United States District Court for the Western District of Tennessee alleging that we infringe a B.E. Technology patent and seeking injunctive relief and monetary damages. We filed our answer on December 31, 2012. The parties are engaged in the initial stage of pretrial discovery.

On November 26, 2012, 1st Technology LLC filed suit against Pandora in the U.S. District Court for the Northern District of Illinois alleging patent infringement. The complaint seeks injunctive relief and monetary damages. On November 20, 2013, the parties negotiated mutually acceptable terms of a settlement of the case. On November 21, 2013, the court dismissed the complaint with prejudice, granting the plaintiff leave to refile if a written settlement agreement is not signed.

On February 26, 2013, Macrosolve, Inc. filed suit against Pandora in the U.S. District Court for the Eastern District of Texas alleging that we infringe a Macrosolve, Inc. patent and seeks injunctive relief and monetary damages. Our answer and counterclaims were filed on April 22, 2013. The parties are engaged in pretrial discovery.

We currently believe that we have substantial and meritorious defenses to the claims in the lawsuits discussed above and intend to vigorously defend our position.

We are also subject to legal proceedings involving musical work royalty rates. On November 5, 2012, we filed a petition in the rate court established by the consent decree between the American Society of Composers, Authors and Publishers (ASCAP) and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015.

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On June 11, 2013 we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights ASCAP could license on behalf of such publishers subsequent to the date of our request for a license from ASCAP were not valid as to our ASCAP consent decree license. On September 17, 2013, our motion for partial summary judgment was granted, alleviating the need to negotiate direct licenses for such purportedly withdrawn performance rights. A trial to determine the royalty rates we will pay ASCAP is set to take place in January 2014.

On June 13, 2013, Broadcast Music, Inc. (BMI) filed a petition in the rate court established by the consent decree between BMI and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2017. We filed our response on July 19, 2013. On November 1, 2013, we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights BMI could license on behalf of such publishers subsequent to the date of our request for a license from BMI were not valid as to our BMI consent decree license.

The outcome of any litigation is inherently uncertain. Based on our current knowledge we believe that the final outcome of the matters discussed above will not likely, individually or in the aggregate, have a material adverse effect on our business, financial position, results of operations or