

Pandora Media, Inc.
Form 424B4
June 15, 2011

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Filed Pursuant to Rule 424(b)(4)
Registration No. 333-172215

PROSPECTUS

14,684,000 Shares

COMMON STOCK

Pandora Media, Inc. is offering 6,000,682 shares of its common stock and the selling stockholders are offering 8,683,318 shares of common stock. We will not receive any proceeds from the sale of shares by the selling stockholders. This is our initial public offering and no public market exists for our shares.

Our common stock has been approved for listing on The New York Stock Exchange under the symbol P.

Investing in the common stock involves risks. See Risk Factors beginning on page 11.

PRICE \$16.00 A SHARE

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	<i>Price to Public</i>	<i>Underwriting Discounts and Commissions</i>	<i>Proceeds to Company</i>	<i>Proceeds to Selling Stockholders</i>
<i>Per Share</i>	\$16.00	\$1.12	\$14.88	\$14.88
<i>Total</i>	\$234,944,000	\$16,446,080	\$89,290,148	\$129,207,772

Pandora Media, Inc. has granted the underwriters the right to purchase up to an additional 2,202,600 shares of common stock to cover over-allotments.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares to purchasers on June 20, 2011.

MORGAN STANLEY

J.P. MORGAN

CITI

WILLIAM BLAIR & COMPANY

STIFEL NICOLAUS WEISEL

WELLS FARGO SECURITIES

June 14, 2011

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We, the selling stockholders and the underwriters have not authorized anyone to provide any information other than that contained or incorporated by reference in this prospectus or in any free writing prospectus prepared by or on behalf of us or to which we have referred you. We take no responsibility for, and can provide no assurance as to the reliability of, any other information that others may give you. We and the selling stockholders are offering to sell and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information in this prospectus or a free-writing prospectus is accurate only as its date, regardless of its time of delivery or of any sale of shares of our common stock. Our business, financial condition, results of operations and prospects may have changed since that date.

Until July 9, 2011, all dealers that buy, sell or trade shares of our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Unless the context requires otherwise, the words "Pandora," "the company," "we," "us" and "our" refer to Pandora Media, Inc. For purposes of this prospectus, the term "stockholders" shall refer to holders of our common stock.

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PROSPECTUS SUMMARY

This summary highlights selected information contained elsewhere in this prospectus and is qualified in its entirety by the more detailed information and financial statements included elsewhere in this prospectus. This summary may not contain all of the information that you should consider before deciding to invest in our common stock. You should read this entire prospectus carefully, including the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and accompanying notes before making an investment decision.

PANDORA MEDIA, INC.

Our Mission

Our mission is to enrich people's lives by enabling them to enjoy music they know and discover music they'll love, anytime, anywhere. People connect with music on a fundamentally personal and deeply emotional level. Whether it's a song someone first heard ten years ago or one they've just discovered, if they connect with that music on our service, a strong bond is forged at that moment with Pandora. Just as we value music, we also hold a deep respect for those who create it. We celebrate and hold dear the individuals who have chosen to make music, from megastars to talented new and emerging artists.

Who We Are

Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners. 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. In April 2011, we had over 90 million registered users and we added a new registered user every second on average. We have more than a 50% share of all internet radio listening time among the top 20 stations and networks in the United States, according to a November 2010 report by Ando Media, or Ando, an audience measurement and ads management firm. Since we launched the Pandora service in 2005, our listeners have created over 1.4 billion stations.

The Music Genome Project and our playlist generating algorithms form the technology foundation that enables us to deliver personalized radio to our listeners. These proprietary technologies power our ability to predict listener music preferences and play music content suited to the tastes of each individual listener. The extensive musicological database of the Music Genome Project has been meticulously built by a team of professional musicians and musicologists analyzing up to 450 attributes, or genes, for every song in our vast collection, to capture the fundamental musical properties of each recording. When a listener enters a single song, artist, composer or genre to start a station—a process we call seeding—our complex mathematical algorithms combine the genes cataloged by the Music Genome Project with individual and collective feedback to suggest songs and build personalized playlists. Over the last decade, our music analysts have been analyzing songs, our engineers have been organizing the genome and refining our playlist generating algorithms and, since the launch of our service five years ago, our listeners have been giving us feedback as they use our service. Containing over 800,000 songs from over 80,000 artists, we believe the Music Genome Project is the most comprehensive analysis of music in the world.

We make the Pandora service available through a variety of distribution channels. In addition to streaming our service to traditional computers, we have developed Pandora applications for smartphones, such as Android phones, Blackberry phones and the iPhone, and partnered with the

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makers of over 200 consumer electronics devices, including Alpine, Panasonic, Pioneer, Samsung and Sony. We have also developed relationships with major automobile manufacturers, including Ford Motor Company, Mercedes-Benz and MINI (BMW Group), and with suppliers to major automobile manufacturers, to integrate the Pandora service into current and future

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automotive sound systems. Additionally, General Motors, Hyundai and Toyota have publicly announced their plans for future Pandora integrations. To date, the Pandora app has been downloaded more than 50 million times on the most popular smartphone platforms in the United States. According to a September 2010 report by Nielsen, a media measurement firm, the Pandora app is a top five most used app across all four major smartphone platforms in the United States. In January 2011, the Pandora app was the #2 all-time downloaded free iPhone app and the #1 all-time downloaded free iPad app, according to Apple.

We offer our service to listeners at no cost and we generate revenue primarily from advertising. We also offer a subscription service to listeners. Our advertising solutions address three large advertising markets in the United States: online display, rich media and video, mobile and broadcast radio. The online display, rich media and video advertising market was \$9.8 billion in 2010, and is expected to grow at a 15% compound annual growth rate to \$17.0 billion in 2014, according to IDC, a provider of market intelligence. Just as shifting consumer consumption to online media has driven online advertising growth, the mobile advertising market is expected to grow as more users access the internet through mobile devices. IDC estimates that in 2010 there were 103 million consumer mobile devices using the internet in the United States, and forecasts that this number will grow to 168 million in 2014. Along with consumer mobile internet usage growth, mobile advertising is expected to grow rapidly, from \$877 million in 2010 to \$6.8 billion in 2014, a 67% compound annual growth rate according to IDC. Our audio advertising products also address the broadcast radio ad market which was \$13.4 billion in 2010 and is expected to reach \$13.7 billion in 2014, according to IDC. We have a significant opportunity to serve the needs of both national and local advertising customers in these three markets.

Our revenue was \$55.2 million, \$137.8 million and \$51.0 million in fiscal 2010 and 2011 and the three months ended April 30, 2011, respectively. Our net loss was \$16.8 million, \$1.8 million and \$6.8 million in fiscal 2010 and 2011 and the three months ended April 30, 2011, respectively, and we expect to continue to incur operating losses on an annual basis through at least fiscal 2012.

How We Are Redefining Radio

Radio has accounted for approximately 80% of audio entertainment listening hours every year from 2002 to 2009, according to the Veronis Suhler Stevenson, or VSS, Communications Industry Forecasts, 22nd and 24th Editions. In addition, in 2009, listeners averaged 13 hours per week of audio entertainment listening on the radio, compared to approximately three hours per week for owned recorded music on formats such as CDs or MP3s, according to VSS. We are redefining radio from the traditional one-to-many programming of broadcast radio to a truly personalized one-to-one radio listening experience. We believe the following competitive strengths will help us realize the potential of our opportunity:

We Enable Personalization and Discovery. Unlike traditional radio stations that broadcast the same content at the same time to all of their listeners, we enable each of our listeners to create up to 100 personalized stations. We believe the promotion of music discovery is one of the reasons why radio has endured as the most popular way to listen to music and that our personalized playlist generating system more effectively introduces listeners to music they will love.

We Listen to Our Listeners. We continue to build a highly-recognized brand by providing a high quality service. We believe the greatest contributor to our growth has been our passionate listeners sharing their positive experiences with their friends, families and other music fans. Pandora has grown primarily by word-of-mouth, and as a result, we have been able to build our brand with relatively low marketing costs.

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We've Pioneered a Personalized Playlist Generating System. Our proprietary personalized playlist generating system enables us to predict listener music preferences and stream music content that is tailored to individual music tastes.

Genotyping Music. Our music analysts measure up to 450 attributes per song that collectively capture a song's musical attributes everything from melody, harmony and instrumentation to rhythm, vocals and lyrics.

Leveraging Individual and Collective Feedback. While listening to a station, our listeners provide feedback by selecting a thumbs-up (I like this song) or a thumbs-down (I don't like this song). These thumbs teach us more about our listeners' preferences and we use them to adapt and improve the playlist for each listener in real-time. In 2010, we received an aggregate of over three billion thumbs, and since the launch of our service we have collected over ten billion thumbs.

Developing and Refining Playlist Generating Algorithms. We have developed, and continue to refine, complex mathematical algorithms that combine the musical analysis from the Music Genome Project with the individual and collective feedback we receive from our listeners to predict music preferences and generate personalized playlists.

Building Our Catalog. We add thousands of songs per month to the Music Genome Project based on music selected by our curators, feedback from our listeners and independent submissions by artists. Our vast catalog of songs represent nearly every recorded musical genre, from classical, jazz, rock, pop and hip hop to post punk, Celtic and flamenco.

We've Built a Multi-Channel Distribution Ecosystem. We work closely with our distribution partners, including manufacturers of smartphones, consumer electronics products and automotive sound systems, so that our listeners can enjoy personalized radio anytime, anywhere.

Why Our Listeners Choose Pandora

We Provide a High Quality Personalized Experience Full of Discovery. Each of our listeners can create up to 100 internet radio stations personalized for his or her tastes, mood, situation or venue. The Pandora service bridges the gap between music owned by listeners, which does not promote discovery, and mass-market broadcast radio, which is not personalized.

Pandora is Free and Easy. Getting started on Pandora is free and easy. Our interface is simple, intuitive and uncluttered. Our goal is to have listeners tapping their feet to music they love the moment they access the Pandora service. In addition to creating a station by selecting a song or artist, we offer genre stations to make seeding a station even easier. Listeners can also learn about artists, songs and lyrics and easily access online music stores to purchase singles or albums with a few simple clicks.

We're Everywhere Our Listeners Want Us to Be. Music is a part of everyday life for most people. Thanks to the proliferation of broadband internet access and internet-connected devices and our strong multi-partner ecosystem, listeners can access the Pandora service wherever they want. Our listeners can tune in at work, in the car, at home and virtually anywhere they want.

Why Our Advertisers Choose Pandora

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Reaching Millions of People, One at a Time. We had over 90 million registered users as of April 2011 and in our fiscal year ended January 31, 2011, we streamed approximately 3.8 billion hours of radio listening. On the Pandora service, advertisers are able to reach listeners in ways that are not possible for broadcast radio, which uses listener survey data to estimate a likely audience size and composition at any given time. We enable both

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national and local advertisers to reach individual listeners based on their age, gender, zip code and music preferences and provide analytics for our advertisers detailing characteristics of the listeners their campaigns reached. Our listeners actively participate with our service, providing advertisers the opportunity to interact with them.

Multi-Platform Ad Solutions. We provide display, audio and video advertising products across multiple distribution platforms. Our advertisers have the ability to design multi-platform campaigns that reach our listeners wherever they enjoy listening to music. Our advertisers can seamlessly combine audio ads with rich display ads to create an immersive branding environment. With one of the top mobile device apps and a mobile listenership that has surpassed our traditional computer listenership, we believe we are well-positioned to continue to innovate in this market.

Enhanced Messaging Environment. Our advertising products are integrated with the listening experience and are designed to minimize disruption to our listeners while enhancing their engagement with ads. Our uncluttered listener interface maximizes the impact of our advertisers messages. Our display and video advertising products are generally served when listeners click on the Pandora service, such as when they change a station or thumbs-up a song, further enhancing listener engagement with our advertisers messages. In addition, on average, we currently run less than one minute of audio ads per hour of listening. By comparison, the three major radio networks averaged approximately 13 minutes of ads per hour in 2009, according to SNL Kagan, a media and communications research firm.

Listener Growth

We track listener hours, number of registered users and number of active users because they are key indicators of the growth of our business. The charts below set forth on a quarterly basis our listener hours for fiscal 2009, 2010 and 2011 and the three months ended April 30, 2011, as well as our registered users as of the end of each of those periods.

Total Listener Hours⁽¹⁾
(in millions)

Total Registered Users⁽²⁾
(in millions, end of period)

Total Active Users⁽³⁾
(in millions, end of period)

- (1) Listener hours are defined in footnote 3 to our Selected and Other Financial Data.
- (2) Registered users are defined in footnote 4 to our Selected and Other Financial Data.
- (3) Active users are defined in footnote 5 to our Selected and Other Financial Data.

Pandora Tomorrow

Our growth has been driven by making the Pandora service a great experience for our listeners, by broadening the availability of our service and by growing ad revenue in ways that work for both our listeners and our advertisers. We are focused on building a successful long-term business and the key elements of our strategy are to:

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Enhance Our Service. We believe the better job we do creating a great experience, the more listeners we attract, the more they listen, and the more they help us grow through word-of-mouth. As a result, we intend to continue to innovate and improve the Pandora service.

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Develop Innovative Advertising Products. We continue to develop advertising products that are compelling for our advertisers without compromising the experience for our listeners.

Build Our Ad Sales Force and Support Organization. We are building our sales force to further our penetration of national and local advertisers.

Expand Distribution. We are expanding our reach to new mobile, consumer electronics and automotive platforms.

Expand to Other Geographies. We believe there is a substantial market for online personalized radio outside of the United States, and our long-term goal is to deliver the Pandora service to listeners globally.

Expand Content Formats. Although music format stations represent approximately 80% of total radio share according to Arbitron, a media and marketing research firm, many radio listeners are drawn to comedy, sports, talk, news and other forms of content beyond music. In May 2011, we began offering comedy stations that can be personalized to each listener's tastes, and over the long term we think there is an opportunity to offer other types of content in addition to music and comedy.

Risks Related to Our Business

Our business is subject to a number of risks of which you should be aware before making an investment decision. These risks are discussed more fully under the caption "Risk Factors," and include but are not limited to the following:

Internet radio is an emerging market, and if we are unable to increase the number of listeners and listener hours or to convince advertisers of the benefits of our advertising products, our business and future prospects will be harmed.

Our mobile listenership has experienced significant growth since we introduced the first mobile version of our service in May 2007, and we have plans to increase the number of listeners who use the Pandora service on mobile devices. However, according to IDC, the percentage of U.S. advertising spending allocated to advertising on mobile devices was less than 1% in 2010, compared to 13% for all online advertising. If we are unable to increase revenue from our advertising products delivered to mobile devices, our results of operations will be materially adversely affected.

We face many competitive challenges, any of which could adversely affect our prospects, results of operations and financial condition.

Our current business plan depends upon arrangements pursuant to which we obtain licenses from, and pay royalties to, copyright owners of both musical works and sound recordings. The rates we pay for the use of sound recordings for the years 2006 through 2015 were negotiated and settled following an adverse ruling by the U.S. Copyright Royalty Board and there is no guarantee that the rates to which we may be subject thereafter will allow us to reach sustained profitability.

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Our ability to increase the number of our listeners will depend in part on our ability to establish and maintain relationships with makers of connected devices, our ability to make our technologies compatible with their platforms and consumer acceptance of the products that integrate our service.

Our business and prospects depend on the strength of our brand and failure to maintain and enhance our brand would harm our ability to expand our base of listeners, advertisers and other partners and may require us to increase our marketing expenses, which would adversely affect our results of operations.

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Corporate Information

We were incorporated in the State of California in January 2000 as TheSavageBeast.com, Inc. and changed our name in May 2000 to Savage Beast Technologies Incorporated. In July 2005, we changed our name to Pandora Media, Inc. In December 2010, we became a Delaware corporation by way of a merger with and into a wholly-owned Delaware subsidiary, with the Delaware subsidiary remaining as the surviving corporation with the name Pandora Media, Inc. following the merger.

We have a January 31 fiscal year end. Accordingly, all references herein to a fiscal year refer to the 12 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.

Our principal executive offices are located at 2101 Webster Street, Suite 1650, Oakland, California 94612 and our telephone number is (510) 451-4100. Our website is www.pandora.com. The information on or that can be accessed through our website is not part of, and is not incorporated, into this prospectus.

Pandora®, the Music Genome Project® and other trademarks or services marks of Pandora appearing in this prospectus are the property of Pandora. All other service marks, trademarks and trade names referred to in this prospectus are property of their respective holders.

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THE OFFERING

Common stock offered by Pandora	6,000,682 shares
Common stock offered by the selling stockholders	8,683,318 shares
Total common stock offered	14,684,000 shares
Over-allotment option	2,202,600 shares (to be granted by us)
Common stock to be outstanding after this offering	159,727,692 shares, or 161,930,292 shares if the underwriters exercise in full their option to purchase additional shares from us based on the number of shares of common stock outstanding as of April 30, 2011.
Dividend policy	Except for the payment of accrued and unpaid dividends on our redeemable convertible preferred stock upon conversion of such redeemable convertible preferred stock in connection with the closing of this offering, we do not anticipate paying any dividends in the foreseeable future. See the sections captioned <i>Use of Proceeds</i> and <i>Dividend Policy</i> for additional information.
Use of proceeds	<p>We estimate that the net proceeds to us from the sale of the shares of common stock offered by us will be approximately \$85.5 million, or approximately \$118.3 million if the underwriters' over-allotment option is exercised in full, based upon an initial public offering price of \$16.00 per share and after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We will not receive any of the proceeds from the sale of common stock by the selling stockholders.</p> <p>We will use a portion of the net proceeds of this offering to pay accrued and unpaid dividends on our redeemable convertible preferred stock in connection with the automatic conversion of such redeemable convertible preferred stock into common stock upon the closing of this offering. The amount of such accrued dividends will be equal to (1) approximately \$29.7 million, which is the amount of accrued dividends if the closing had occurred on April 30, 2011, plus (2) approximately \$26,000 per day for the period from April 30, 2011 to the date of the closing. We anticipate that we will use the remaining net proceeds of this offering for general corporate purposes, including working capital. We may also use a portion of the net proceeds to acquire, invest in, or obtain rights to, complementary technologies, products, services or businesses. There are no such transactions under consideration at this time. See the section captioned <i>Use of Proceeds</i> for additional information.</p>
NYSE symbol	P

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The number of shares of our common stock to be outstanding after this offering is based on 152,521,033 shares of our common stock outstanding as of April 30, 2011 and excludes:

36,675,288 shares of common stock issuable upon the exercise of outstanding options to purchase our common stock at a weighted average exercise price of approximately \$1.35 per share;

154,938 shares of common stock issuable upon exercise of warrants at a weighted average exercise price of approximately \$0.77 per share;

1,369,357 shares of common stock reserved for issuance under our existing stock option plan; and

12,000,000 shares of our common stock reserved for issuance under our 2011 Long-Term Incentive Plan, plus annual increases thereunder, as described in the section captioned Executive Compensation-Employee Benefit Plans-2011 Long-Term Incentive Plan.

Unless otherwise indicated, all information in this prospectus reflects and assumes the following:

no exercise by the underwriters of their option to purchase up to 2,202,600 additional shares of our common stock from us;

the conversion of outstanding warrants to purchase shares of our redeemable convertible preferred stock into warrants to purchase 154,938 shares of common stock upon the closing of this offering;

the automatic conversion of all of our outstanding redeemable convertible preferred stock into an aggregate of 137,294,574 shares of common stock upon the closing of this offering and the payment in cash of accrued dividends on such shares in connection with such conversion;

no exercise of options or warrants outstanding as of April 30, 2011, except for 957,617 shares of common stock to be issued and sold in this offering upon the exercise of vested stock options at a weighted average exercise price of approximately \$0.16 per share, and 248,360 shares of common stock to be issued and sold in this offering upon the exercise of warrants at a weighted average exercise price of approximately \$0.66 per share; and

the filing of our amended and restated certificate of incorporation and the adoption of our amended and restated bylaws immediately prior to the effectiveness of the offering.

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The following tables summarize financial data regarding our business. You should read the following summary financial and other data in conjunction with Selected Financial and Other Data and Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes included elsewhere in this prospectus. We derived the statements of operations data for the years ended January 31, 2009, 2010 and 2011 and balance sheet data as of January 31, 2011 from our audited financial statements included elsewhere in this prospectus. We derived the unaudited statement of operations data for the three months ended April 30, 2010 and 2011 and the balance sheet data as of April 30, 2011 from our unaudited financial statements included elsewhere in this prospectus. The pro forma, as adjusted balance sheet data reflects balance sheet data as of April 30, 2011 after giving pro forma effect to the automatic conversion of all outstanding redeemable convertible preferred stock into common stock upon the closing of this offering, our receipt of the net proceeds from the sale by us in this offering of 6,000,682 shares of common stock at an initial public offering price of \$16.00 per share and after deducting underwriting discounts and commissions and estimated offering expenses payable by us, our receipt of the proceeds from the exercise of stock options and warrants to purchase 1,205,977 shares of common stock that will be sold in this offering and the application of the net proceeds we will receive from this offering in the manner described in Use of Proceeds. The unaudited interim financial statements data has been prepared on the same basis as the audited financial statements and reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial information set forth in those statements. Our historical results are not necessarily indicative of results to be expected in any future period, and results for the three months ended April 30, 2011 are not necessarily indicative of results to be expected for the full fiscal year.

	Fiscal Year Ended January 31,			Three Months Ended	
	2009	2010	2011	April 30,	2011
	(in thousands, except per share data)				
Statement of Operations Data:					
Revenue:					
Advertising	\$ 18,247	\$ 50,147	\$ 119,333	\$ 18,446	\$ 43,661
Subscription services and other	1,086	5,042	18,431	3,153	7,379
Total revenue	19,333	55,189	137,764	21,599	51,040
Costs and expenses:					
Cost of revenue ⁽¹⁾	7,398	7,892	11,559	2,390	4,360
Product development ⁽¹⁾	6,116	6,026	6,736	1,499	2,731
Marketing and sales ⁽¹⁾	13,265	17,426	36,250	5,433	12,964
General and administrative ⁽¹⁾	4,190	6,358	14,183	2,471	6,943
Content acquisition	15,771	32,946	69,357	12,616	29,158
Total costs and expenses	46,740	70,648	138,085	24,409	56,156
Loss from operations	(27,407)	(15,459)	(321)	(2,810)	(5,116)
Other expense, net	(821)	(1,294)	(1,309)	(194)	(1,616)
Loss before provision for income taxes	(28,228)	(16,753)	(1,630)	(3,004)	(6,732)
Provision for income taxes			134		22
Net loss	(28,228)	(16,753)	(1,764)	(3,004)	(6,754)
Deemed dividend on Series D and Series E		(1,443)			
Accretion of redeemable convertible preferred stock	(58)	(218)	(300)	(81)	(70)
Increase in cumulative dividends payable upon conversion of liquidation of redeemable convertible preferred stock	(3,751)	(6,461)	(8,978)	(1,883)	(2,320)
Loss attributable to common stockholders	\$ (32,037)	\$ (24,875)	\$ (11,042)	\$ (4,968)	\$ (9,144)
Basic and diluted net loss per share attributable to common stockholders	\$ (5.45)	\$ (3.84)	\$ (1.03)	\$ (0.64)	\$ (0.61)
Weighted-average number of shares used in computing per share amounts	5,881	6,482	10,761	7,791	14,900

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Pro forma net loss per share attributable to common stockholders:

Basic and diluted (unaudited)	\$ (0.01)	\$ (0.03)
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Pro forma weighted average shares used to compute pro forma net loss per share attributed to common stockholders:

Basic and diluted (unaudited)	147,213	154,050
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	Fiscal Year Ended January 31,			Three Months Ended April 30,	
	2009	2010	2011	2010	2011
Listener hours (in billions) ⁽²⁾	0.9	1.8	3.8	0.7	1.6
Registered users (end of period, in millions) ⁽³⁾	22	45	82	53	94
Active users (end of period, in millions) ⁽⁴⁾	7	16	29	18	34

	As of April 30, 2011	
	Actual	Pro Forma, as Adjusted (unaudited)
Balance Sheet Data (in thousands):		
Cash and cash equivalents	\$ 43,718	\$ 101,937
Working capital	36,218	94,437
Total assets	101,605	157,733
Preferred stock warrant liabilities	2,550	
Redeemable convertible preferred stock	128,757	
Common stock and additional paid-in capital	1,306	188,741
Total stockholders' deficit	(90,767)	96,668

(1) Includes stock-based compensation as follows:

	Fiscal Year Ended January 31,			Three Months Ended April 30,	
	2009	2010	2011	2010	2011
	(in thousands)				
Cost of revenue	\$ 14	\$ 18	\$ 85	\$ 6	\$ 64
Product development	54	125	329	40	177
Marketing and sales	188	225	549	76	423
General and administrative	77	109	492	70	272
Total stock-based compensation	\$ 333	\$ 477	\$ 1,455	\$ 192	\$ 936

(2) Listener hours are defined in footnote 3 to our Selected Financial and Other Data.

(3) Registered users are defined in footnote 4 to our Selected Financial and Other Data.

(4) Active users are defined in footnote 5 to our Selected Financial and Other Data.

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RISK FACTORS

Investing in our common stock involves a high degree of risk. Before deciding to invest in our common stock, you should carefully consider each of the following risk factors and all other information set forth in this prospectus and any related free writing prospectus. The following risks and the risks described elsewhere in this prospectus, including in the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations, could materially harm our business, financial condition, operating results, cash flow and prospects. If that occurs, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Related to Our Business

Internet radio is an emerging market, which makes it difficult to evaluate our current business and future prospects.

Internet radio is an emerging market and our current business and future prospects are difficult to evaluate. The market for internet radio has undergone rapid and dramatic changes in its relatively short history and is subject to significant challenges. As a result, the future revenue and income potential of our business is uncertain. You should consider our business and prospects in light of the risks and difficulties we encounter in this new and rapidly evolving market, which risks and difficulties include, among others:

our relatively new, evolving and unproven business model;

our ability to retain our current listenership, build our listener base and increase listener hours;

our ability to effectively monetize listener hours, particularly with respect to listener hours on mobile devices;

our ability to attract new advertisers, retain existing advertisers and prove to advertisers that our advertising platform is effective enough to justify a pricing structure that is profitable for us;

our ability to maintain relationships with makers of mobile devices, consumer electronic products and automobiles; and

our operation under an evolving music industry licensing structure that may change or cease to exist, which in turn may result in a significant increase in our operating expenses.

Failure to successfully address these risks and difficulties, and other challenges associated with operating in a new and emerging market, could inhibit the implementation of our business plan, significantly harm our financial condition, operating results and liquidity and prevent us from achieving or sustaining profitability.

We have incurred significant operating losses in the past and may not be able to generate sufficient revenue to be profitable.

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Since our inception in 2000, we have incurred significant net operating losses and as of April 30, 2011, we had an accumulated deficit of \$92.1 million. A key element of our strategy is to increase the number of listeners and listener hours to increase our market penetration. However, as our number of listener hours increases, the royalties we pay for content acquisition also increase. We have not in the past generated, and may not in the future generate, sufficient revenue from the sale of advertising and subscriptions to offset such royalty expenses. If we cannot successfully earn revenue at a rate that exceeds the operational costs associated with increased listener hours, we may not be able to achieve or sustain profitability. In addition, we expect to invest heavily in our operations to support anticipated future growth and public company reporting and compliance obligations. As a result of these factors, we expect to continue to incur operating losses on an annual basis through at least fiscal 2012.

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Our revenue increased rapidly in each of the fiscal years ended January 31, 2007 through January 31, 2011; however, we expect our revenue growth rate to decline in the future as a result of a variety of factors, including increased competition and the maturation of our business, and we cannot assure you that our revenue will continue to grow or will not decline. You should not consider our historical revenue growth or operating expenses as indicative of our future performance. If our revenue growth rate declines or our operating expenses exceed our expectations, our financial performance will be adversely affected. Further, if our future growth and operating performance fail to meet investor or analyst expectations, it could have a materially negative effect on our stock price.

In addition, in our efforts to increase revenue as the number of listener hours has grown, we have expanded and expect to continue to expand our sales force. If our hiring of additional sales personnel does not result in a sufficient increase in revenue, the cost of this additional headcount will not be offset, which would harm our operating results and financial condition.

Our failure to convince advertisers of the benefits of our service in the future could harm our business.

For our fiscal year ended January 31, 2011 and the three months ended April 30, 2011, we derived 86.6% and 85.5%, respectively, of our revenue from the sale of advertising and expect to continue to derive a substantial majority of our revenue from the sale of advertising in the future. Our ability to attract and retain advertisers, and ultimately to generate advertising revenue, depends on a number of factors, including:

increasing the number of listener hours;

keeping pace with changes in technology and our competitors;

competing effectively for advertising dollars from other online marketing and media companies;

penetrating the market for local radio advertising;

continuing to develop and diversify our advertisement platform, which currently includes delivery of display, audio and video advertising products through multiple delivery channels, including traditional computers, mobile and other connected devices, including automobiles; and

coping with ad blocking technologies that have been developed and are likely to continue to be developed that can block the display of our ads.

Our agreements with advertisers are generally short term or may be terminated at any time by the advertiser. Advertisers are spending only a small amount of their overall advertising budget on our service, may view advertising with us as experimental and unproven and may leave us for competing alternatives at any time. We may never succeed in capturing a greater share of our advertisers' core advertising spending, particularly if we are unable to achieve the scale and market penetration necessary to demonstrate the effectiveness of our advertising platforms, or if our advertising model proves ineffective or not competitive when compared to alternatives. Failure to demonstrate the value of our service would result in reduced spending by, or loss of, existing or potential future advertisers, which would materially harm our revenue and business.

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Advertising on mobile devices, such as smartphones, is an emerging phenomenon, and if we are unable to increase revenue from our advertising products delivered to mobile devices, our results of operations will be materially adversely affected.

Our number of listener hours on mobile devices has surpassed listener hours on traditional computers, and we expect that this trend will continue. Our mobile listenership has experienced significant growth since we introduced the first mobile version of our service in May 2007. Listener hours on mobile devices constituted approximately 4.6%, 23.5%, 50.5% and 60.3% of our total listener hours for fiscal years 2009, 2010 and 2011 and the three months ended April 30, 2011, respectively. We expect this growth to continue, though at a less rapid pace. Advertising on mobile devices is an emerging phenomenon, and the percentage of advertising

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spending allocated to advertising on mobile devices is lower than online advertising. According to IDC, the percentage of U.S. advertising spending allocated to advertising on mobile devices was less than 1% in 2010, compared to 13% for all online advertising. Our cost of content acquisition is currently calculated on the same basis whether a listening hour is consumed on a traditional computer or a mobile device. To date, we have not been able to generate revenue from our advertising products delivered to mobile devices as effectively as we have for our advertising products served on traditional computers. While a substantial amount of our revenue has been derived from display ads, some display ads may not be currently optimized for use on certain mobile devices. For example, display ads are not well-suited for use on smartphones due to the size of the device screen and may not be appropriate for automobiles due to safety considerations. Further, some display ads may not be optimized to take advantage of the multimedia capabilities of connected devices. By contrast, audio ads are better-suited for delivery in automobiles and across mobile and connected device platforms and video ads can be optimized for a variety of platforms. Our audio and video advertising products are relatively new and have not been as widely accepted by advertisers as our traditional display ads. In addition, the introduction of audio advertising places us in more direct competition with terrestrial radio, as many advertisers that purchase audio ads focus their spending on terrestrial radio stations. One challenge we face in promoting audio ads is thus overcoming any reluctance of these advertisers to migrate their advertising spend to online advertising. We have plans to increase our number of listener hours on mobile and other connected devices, including our efforts to expand the reach of our service by making it available on an increasing number of such devices, such as smartphones and devices connected to or installed in automobiles, and we cannot assure you that we will be able to effectively monetize inventory generated by listeners using mobile and connected devices, or the time frame on which we may do so.

Unavailability of, or fluctuations in, third-party measurements of our audience may adversely affect our ability to grow advertising revenue.

Selling ads requires that we demonstrate to advertisers that our service has substantial reach, and we rely on third parties to quantify the reach of our service. These third-party ratings may not reflect our true listening audience and the third parties may change their methodologies. Third-party independent rating agencies have not yet developed rating systems that comprehensively and accurately measure the reach of our service, especially on mobile and consumer electronic devices. We expect that in the future these rating agencies will begin to publish increasingly reliable information about the reach of our service. However, until then, in order to demonstrate to potential advertisers the reach of our service, we must supplement third-party ratings data with our internal research, which is perceived as less reliable than third-party numbers. If our mobile audience becomes rated, it is not clear whether the measurement technology of the third-party rating agencies will initially integrate with ours or whether their methodology will accurately reflect the value of our service. If such third-party ratings are inaccurate or we receive low ratings, our ability to convince advertisers of the benefits of our service would be adversely affected.

Our success depends upon the continued acceptance of online advertising as an alternative or supplement to offline advertising.

The percentage of the advertising market allocated to online advertising lags the percentage of time spent by people consuming media online by a significant degree. Growth of our business will depend in large part on the reduction or elimination of this gap between online and offline advertising spending, which may not happen in a way or to the extent that we currently expect. Many advertisers still have limited experience with online advertising and may continue to devote significant portions of their advertising budgets to traditional, offline advertising media. Accordingly, we continue to compete for advertising dollars with traditional media, including broadcast radio.

Although advertisers as a whole are spending an increasing amount of their overall advertising budget on online advertising, we face a number of challenges in growing our advertising revenue. We compete for advertising dollars with significantly larger and more established online marketing and media companies such as

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Facebook, Google, MSN and Yahoo!. We believe that the continued growth and acceptance of our online advertising products will depend on the perceived effectiveness and the acceptance of online advertising models generally, which is outside of our control. Any lack of growth in the market for online advertising could result in reduced revenue or increased marketing expenses, which would harm our operating results and financial condition.

If our efforts to attract prospective listeners and to retain existing listeners are not successful, our growth prospects and revenue will be adversely affected.

Our ability to grow our business and generate advertising revenue depends on retaining and expanding our listener base and increasing listener hours. We must convince prospective listeners of the benefits of our service and existing listeners of the continuing value of our service. The more listener hours we stream, the more ad inventory we have to sell. Further, growth in our listener base increases the size of demographic pools targeted by advertisers, which improves our ability to deliver advertising in a manner that maximizes our advertising customers' return on investment and, ultimately, to demonstrate the effectiveness of our advertising solutions and justify a pricing structure that is profitable for us. If we fail to grow our listener base and listener hours particularly in key demographics such as young adults, we will be unable to grow advertising revenue, and our business will be materially and adversely affected.

Our ability to increase the number of our listeners and listener hours will depend on effectively addressing a number of challenges and we may fail to do so. Some of these challenges include:

providing listeners with a consistent high quality, user-friendly and personalized experience;

continuing to build our catalogs of music and comedy content that our listeners enjoy;

continuing to innovate and keep pace with changes in technology and our competitors; and

maintaining and building our relationships with makers of consumer products such as mobile devices, other consumer electronic products and automobiles to make our service available through their products.

In addition, we have historically relied heavily on the success of viral marketing to expand consumer awareness of our service. If we are unable to maintain or increase the efficacy of our viral marketing strategy, or if we otherwise decide to expand the reach of our marketing through use of more costly marketing campaigns, we will experience an increase in marketing expenses, which could have an adverse effect on our results of operations. We cannot assure you that we will be successful in maintaining or expanding our listener base and failure to do so would materially reduce our revenue and adversely affect our business, operating results and financial condition.

Further, although we use our number of registered users and our number of active users as indicators of our brand awareness and the growth of our business, the number of registered users and number of active users exceeds the number of unique individuals who register for, or actively use, our service for a number of reasons. We define registered users as the total number of accounts that have been created for our service and we define active users as the number of distinct registered users that have requested audio from our servers within the trailing 30 days from the end of each calendar month. To establish an account, a person must provide an email address and a user name, but no personally unique information and a person may have multiple accounts. If the number of actual listeners does not result in an increase in listener hours, then our business may not grow as quickly as we expect, which may harm our business, operating results and financial condition.

We face and will continue to face competition for both listener hours and advertising spending.

We compete with other content providers for listener hours.

We compete for the time and attention of our listeners with other content providers on the basis of a number of factors, including quality of experience, relevance, acceptance and diversity of content, ease of use, price, accessibility, perception of ad load and brand awareness and reputation.

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Our competitors include terrestrial radio providers such as CBS and Clear Channel, satellite radio providers such as Sirius XM, online radio providers such as iheartradio, Last.fm and Slacker Personal Radio, subscription online on-demand music providers such as RDIO and Rhapsody and potential U.S. market entrants like Spotify. Terrestrial radio providers offer their content for free, are well-established and accessible to listeners and offer content, such as news, sports, traffic, weather and talk, that we currently do not. In addition, many terrestrial radio stations have begun broadcasting digital signals, which provide high quality audio transmission. Satellite radio providers offer extensive and oftentimes exclusive news, comedy, sports and talk content, national signal coverage, and long established automobile integration. Select online providers offer more extensive content libraries and can be accessed internationally, while online on-demand services give listeners total control to choose their content.

We also compete more broadly with providers of alternative forms of audio media and entertainment, which are purchased or available for free and playable on mobile devices, automobiles and in the home, such as iTunes audio files, MP3s, CDs, and other forms of pre-recorded audio, as well as content streams from other online services such as Hulu, VEVO and YouTube. We face increasing competition for listeners from a growing variety of businesses that deliver audio media content through mobile phones and other wireless devices, such as iTunes.

We believe that companies with a combination of financial resources, technical expertise and digital media experience also pose a significant threat of developing competing internet radio and digital audio entertainment technologies in the future. In particular, if known incumbents in the digital media space such as Amazon, Apple, Facebook or Google choose to offer competing services, they may devote greater resources than we have available, have a more accelerated time frame for deployment and leverage their existing user base and proprietary technologies to provide products and services that our listeners and advertisers may view as superior. Our current and future competitors may have more well-established brand recognition, more established relationships with consumer product manufacturers, greater financial, technical, and other resources, more sophisticated technologies or more experience in the markets in which we compete.

We also compete for listeners on the basis of our presence and visibility as compared with other businesses and software that deliver audio and other content through the internet, mobile devices and consumer products. We face significant competition for listeners from companies promoting their own digital music and content online or through application stores, including several large, well-funded and seasoned participants in the digital media market. Search engines, such as Google, and mobile device application stores, such as the iTunes Store, rank responses to search queries based on the popularity of a website or mobile application, as well as other factors that are outside of our control. Additionally, mobile device application stores often offer users the ability to browse applications by various criteria, such as the number of downloads in a given time period, the length of time since a mobile app was released or updated, or the category in which the application is placed. The websites and mobile applications of our competitors may rank higher than our website and our Pandora app, and our app may be difficult to locate in mobile device application stores, which could draw potential listeners away from our service and toward those of our competitors. In addition, our competitors' products may be pre-loaded into consumer electronics products or automobiles, creating an initial visibility advantage. If we are unable to compete successfully for listeners against other digital media providers by maintaining and increasing our presence and visibility online, in application stores and in consumer electronics products and automobiles, our listener hours may fail to increase as expected or decline and our advertising sales will suffer.

To compete effectively, we must continue to invest significant resources in the development of our service to enhance the user experience of our listeners. There can be no assurance that we will be able to compete successfully for listeners in the future against existing or new competitors, and failure to do so could result in loss of existing or potential listeners, reduced revenue, increased marketing expenses or diminished brand strength, any of which could harm our business.

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We compete for advertising spending with other content providers.

We compete for a share of advertisers' overall marketing budgets with other content providers on a variety of factors including perceived return on investment, effectiveness and relevance of our advertising products, pricing structure and ability to deliver large volumes or precise types of ads to targeted demographics.

We face significant competition for advertising dollars from terrestrial and, to a lesser extent, satellite radio providers. As many of the advertisers we target have traditionally advertised on terrestrial radio and have less experience with internet radio providers, they may be reluctant to spend for advertising on traditional computers, mobile or other connected device platforms. In addition, terrestrial radio providers as well as other traditional media companies in television and print, such as broadcast television networks such as ABC, CBS, FOX and NBC, cable television channel providers, national newspapers such as the New York Times and the Wall Street Journal and some regional newspapers, enjoy a number of competitive advantages over us in attracting advertisers, including large established audiences, longer operating histories, greater brand recognition and a growing presence on the internet.

Although advertisers are allocating an increasing amount of their overall marketing budgets to web and mobile-based ads, such spending lags behind growth in internet usage, and the market for online and mobile advertising is intensely competitive. As a result, we also compete for advertisers with a range of internet companies, including major internet portals, search engine companies and social media sites. Large internet companies with greater brand recognition, such as Facebook, Google, MSN and Yahoo! have significant numbers of direct sales personnel and substantial proprietary advertising inventory and web traffic that provide a significant competitive advantage and have a significant impact on pricing for internet advertising and web traffic. The trend toward consolidation among online marketing and media companies may also affect pricing and availability of advertising inventory.

In order to compete successfully for advertisers against new and existing competitors, we must continue to invest resources in developing and diversifying our advertisement platform, harnessing listener data and ultimately proving the effectiveness and relevance of our advertising products. Failure to compete successfully against our current or future competitors could result in loss of current or potential advertisers or a reduced share of our advertisers' overall marketing budget, which could adversely affect our pricing and margins, lower our revenue, increase our research and development and marketing expenses and prevent us from achieving or maintaining profitability.

We operate under statutory licensing structures for the reproduction and public performance of sound recordings that could change or cease to exist, which would adversely affect our business.

We currently operate under statutory licensing regimes and structures that may change or cease to exist. Unlike traditional radio broadcasters, we must pay performance rights royalties for the digital audio transmission of sound recordings pursuant to the Digital Performance Right in Sound Recordings Act and Digital Millennium Copyright Act. Subject to our ongoing compliance with numerous statutory conditions and regulatory requirements for a non-interactive service, we are permitted to operate under a statutory license that allows the streaming in the U.S. of any sound recording lawfully released to the public. We are also permitted to make reproductions of sound recordings on computer servers pursuant to a separate statutory license designed to facilitate the making of transmissions. There is no guarantee that we will continue to be eligible to operate under these statutory licenses. For example, if a court were to determine that we operate an interactive streaming service or make reproductions of sound recordings outside the statutory license, we would have to negotiate license agreements with sound recording copyright owners individually, a time consuming and expensive undertaking that would jeopardize our ability to stream all music currently in our library and could result in royalty costs that are prohibitively expensive. In addition, if copyright owners object to the functionality or transmission methods of our service, we could lose our eligibility to operate under the statutory licenses. Our ability to avoid negotiating separate agreements with the many copyright owners of sound recordings depends on

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these two statutory licenses, and if we were to no longer qualify for operation under, or violate the provisions of the statutory licenses, we could be subject to significant liability for copyright infringement and may no longer be able to operate under our existing licensing regime. For our fiscal year ended January 31, 2011 and the three months ended April 30, 2011, we incurred SoundExchange related content acquisition costs representing 45% and 53%, respectively, of our total revenue for those periods.

The rates to be paid for the streaming of sound recordings pursuant to the statutory licenses can be established by either negotiation or through a rate proceeding conducted by the Copyright Royalty Board, or CRB, a tribunal established within the U.S. Library of Congress. In 2007, the CRB set royalty rates for the online streaming of sound recordings for 2006 through 2010 that were so high that the cost for streaming sound recordings alone would have been unsustainable under our current business model. In response to the lobbying efforts of internet webcasters, including us, Congress passed the Webcaster Settlement Acts of 2008 and 2009, which permitted webcasters and SoundExchange, the sole entity designated by the CRB to collect and distribute the statutory royalties paid by internet webcasters such as us, to negotiate alternative rates to those established by the CRB for the years 2006 through 2015. In July 2009, certain webcasters reached an agreement with SoundExchange, establishing a more favorable royalty structure that we have elected to accept and that by its terms will apply through 2015. We do not know what rates will be available to us following that period and there is no guarantee that the royalty structure that emerged from the negotiations with SoundExchange pursuant to the Webcaster Settlement Acts will be available after 2015. The CRB, which still has rate-making authority over us upon expiration of our agreement with SoundExchange, has consistently established royalty rates that would, if paid by us, consume an unsustainable percentage of our revenue. If we are unable to reach a new agreement with SoundExchange for the period after 2015, our operating costs may significantly increase, which could harm our financial condition and inhibit the implementation of our business plan.

We depend upon third-party licenses for musical works and a change to or loss of these licenses could increase our operating costs or adversely affect our ability to retain and expand our listener base, and therefore could adversely affect our business.

To secure the rights to stream musical works embodied in sound recordings over the internet, we obtain licenses from or for the benefit of copyright owners and pay royalties to copyright owners or their agents. Those who own copyrights in musical works are vigilant in protecting their rights and seek royalties that are very high in relation to the revenue that can be generated from the public performance of such works. There is no guarantee that the licenses available to us now will continue to be available in the future or that such licenses will be available at the royalty rates associated with the current licenses. If we are unable to secure and maintain rights to stream musical works or if we cannot do so on terms that are acceptable to us, our ability to stream music content to our listeners, and consequently our ability to attract and retain advertisers, will be adversely impacted.

In order to stream musical works embodied in sound recordings over the internet, we must obtain public performance licenses and pay license fees to three performing rights organizations: Broadcast Music, Inc., or BMI, SESAC, Inc., or SESAC, and the American Society of Composers, Authors and Publishers, or ASCAP. These organizations represent the rights of songwriters and music publishers, negotiate with copyright users such as us, collect royalties and distribute those royalties to the copyright owners they represent, namely songwriters and music publishers. Performing rights organizations have the right to audit our playlists and royalty payments, and any such audit could result in disputes over whether we have paid the proper royalties. If such a dispute were to occur, we could be required to pay additional royalties and the amounts involved could be material. We currently operate under negotiated agreements with BMI and SESAC, however, these agreements are subject to termination by either party in accordance with their terms at the end of each calendar year, with respect to BMI, and at the end of each yearly term, with respect to SESAC, and there is no guarantee that the associated royalty rates available to us now will be available to us in the future. BMI, pursuant to a consent decree entered into with the U.S. Department of Justice, cannot refuse to grant us licenses for the public performance of musical works represented by BMI but the rates to be paid to BMI can be set, in the absence of a negotiated agreement, by the rate court established pursuant to such decree in the U.S. District Court for the Southern District of New York.

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SESAC is not subject to a mandatory licensing obligation and could withhold the rights to all of the musical works for which it acts as a licensor on behalf of songwriters and music publishers. The loss of the musical works represented by SESAC could diminish the appeal of our service to listeners.

In October 2010, we elected to terminate our prior agreement with ASCAP as of December 31, 2010 because we believe that royalty rates currently sought by ASCAP are excessive. Notwithstanding our termination of the agreement, musical works administered by ASCAP are licensed to us pursuant to the provisions of a consent decree, similar to the BMI consent decree referred to above. The ASCAP consent decree also established a rate court in the U.S. District Court for the Southern District of New York. The rates to be paid by us will be set either by mutual agreement between us and ASCAP, or by a ruling from the ASCAP rate court. Pending a final determination of new rates, we will account to ASCAP on an interim basis at reasonable royalty rates to be established either by mutual agreement or by the ASCAP rate court. If either we or ASCAP request that the rate court determine our royalty rate, rate court proceedings can take years to complete and be very costly. In such a case, there is no guarantee that the rate court will establish royalty rates more favorable to us than those we previously paid pursuant to our license agreement with ASCAP, and we could be liable for both increased royalty rates going forward and a potential true-up of royalty payments in excess of any interim royalties paid for the period following December 31, 2010. For our fiscal year ended January 31, 2011 and the three months ended April 30, 2011, we incurred BMI, SESAC and ASCAP related content acquisition costs representing 4% and 4%, respectively, of our total revenue for those periods.

We do not currently pay so-called mechanical royalties to music publishers for the reproduction and distribution of musical works embodied in transitory copies used to make streams audible to our listeners. Although not currently a matter of dispute, if music publishers were to change their position and seek to be paid mechanical royalties by us, and a final judgment were entered by a court requiring that payment, our royalty obligations could increase significantly, which would increase our operating expenses and harm our business and financial interests.

In May 2011, we started streaming spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization for the United States. While pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization, there can be no assurance that this will not change or that we will not otherwise become subject to additional licensing costs for spoken word comedy content imposed by performing rights organizations in the future.

If music publishers withdraw all or a portion of their catalogs from performing rights organizations such as ASCAP or BMI, we may be forced to enter into direct licensing agreements with these publishers at rates higher than those we currently pay, or may be unable to reach agreement with these publishers at all, which could adversely affect our business, financial condition and results of operations.

In May 2011, EMI Music Publishing, or EMI, announced its decision to withdraw certain licensing rights from ASCAP that EMI had previously authorized ASCAP to manage on its behalf. As a result, ASCAP may no longer be able to license the webcasting of songs from EMI's catalog of musical compositions, and digital music webcasters, such as Pandora, who were previously able to secure licenses from ASCAP for EMI musical compositions may now have to enter into direct licensing arrangements with EMI. Although we continue to be licensed by ASCAP, it is currently unclear what specific effect EMI's limited withdrawal from ASCAP will have on us, or whether other publishers may also choose to withdraw all or a portion of their catalogs from the collection of musical compositions that ASCAP has the authority to license. If we are unable to reach an agreement with respect to the repertoire of EMI or any other music publisher who withdraws all or a portion of its catalog(s) from ASCAP or other performing rights organizations, or if we are forced to enter into direct licensing agreements with publishers at rates higher than those currently set by the performing rights organizations (or the U.S. District Court having supervisory authority over ASCAP and BMI) for the performance of musical works, our ability to stream music content to our listeners may be limited or our

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operating costs may significantly increase, which could adversely affect our business, financial condition and results of operations.

If we fail to accurately predict and play music or comedy content that our listeners enjoy, we may fail to retain existing and attract new listeners.

We believe that a key differentiating factor between the Pandora service and other music content providers is our ability to predict music that our listeners will enjoy. Our personalized playlist generating system, based on the Music Genome Project and our proprietary algorithms, is designed to enable us to predict listener music preferences and select music content tailored to our listeners' individual music tastes. We have invested, and will continue to invest, significant resources in refining these technologies; however, we cannot assure you that such investments will yield an attractive return or that such refinements will be effective. The effectiveness of our personalized playlist generating system depends in part on our ability to gather and effectively analyze large amounts of listener data and listener feedback and we have no assurance that we will continue to be successful in enticing listeners to give a thumbs-up or thumbs-down to enough songs for our database to effectively predict and select new and existing songs. In addition, our ability to offer listeners songs that they have not previously heard and impart a sense of discovery depends on our ability to acquire and appropriately categorize additional songs that will appeal to our listeners' diverse and changing tastes. While we have more than 800,000 songs in our catalog, we must continuously identify and analyze additional songs that our listeners will enjoy and we may not effectively do so. We recently launched comedy on the Pandora service, which are designed to predict comedy content that our listeners will enjoy using technology similar to the technology that we use to generate personalized playlists for music. The risks that apply to predicting our listeners' musical tastes apply to comedy to an even greater extent, particularly as we lack experience with content other than music, do not yet have a large set of data on listener preferences for comedy and have a much smaller comedy catalog as compared to music. Our ability to predict and select music or comedy content that our listeners enjoy is critical to the perceived value of our service among listeners and failure to make accurate predictions would adversely affect our ability to attract and retain listeners, increase listener hours and sell advertising.

Our ability to increase the number of our listeners will depend in part on our ability to establish and maintain relationships with automakers, automotive suppliers and consumer electronics manufacturers and consumer acceptance of the products that integrate our service.

A key element of our strategy to expand the reach of our service and increase the number of our listeners and listener hours is to establish and maintain relationships with automakers, automotive suppliers and consumer electronics manufacturers that integrate our service into and with their products. Working with certain third-party distribution partners, we currently offer listeners the ability to access our service through a variety of consumer electronics products used in the home and devices connected to or installed in automobiles. We intend to broaden our ability to reach additional listeners, and increase current listeners hours, through other platforms and partners over time. However, reaching agreements with distribution partners can be time consuming, and once an agreement is reached, product design cycles can be lengthy. If we are not successful in maintaining existing and creating new relationships, or if we encounter technological, content licensing or other impediments, our ability to grow our business could be adversely impacted.

Our existing agreements with partners in the automobile industry generally do not obligate an automobile manufacturer to launch the integration of our service in its automobiles. In addition, some automobile manufacturers or their supplier partners may terminate their agreements with us for convenience. Our business could be adversely affected if our automobile partners and consumer electronics partners do not continue to provide access to our service or are unwilling to do so on terms acceptable to us. If we are forced to amend the business terms of our distribution agreements as a result of competitive pressure, our ability to maintain and expand the reach of our service and increase listener hours would be adversely affected, which would reduce our revenue and harm our operating results.

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Additionally, we distribute our mobile applications via smartphone application download stores managed by Apple, Google, Palm and Research In Motion, or RIM, and such distribution is subject to an application developer license agreement in each case. Should any of these parties amend the terms of their license in such a way that inhibits our ability to distribute the Pandora apps via their application store, or negatively impacts our economics in such distribution, our ability to increase listener hours and sell advertising would be adversely affected, which would reduce our revenue and harm our operating results.

Loss of agreements with the makers of mobile devices, renegotiation of such agreements on less favorable terms or other actions these third parties may take could harm our business.

Most of our agreements with makers of mobile operating systems and devices through which our service may be accessed, including Apple, RIM and Google, are short term or can be cancelled at any time with little or no prior notice or penalty. The loss of these agreements, or the renegotiation of these agreements on less favorable economic or other terms, could limit the reach of our service and its attractiveness to advertisers. Some of these mobile device makers, including Apple, are now, or may in the future become, competitors of ours, and could stop allowing or supporting access to our service through their products for competitive reasons. Furthermore, because devices providing access to our service are not manufactured and sold by us, we cannot guarantee that these companies will ensure that their devices perform reliably, and any faulty connection between these devices and our service may result in consumer dissatisfaction toward us, which could damage our brand.

If we are unable to continue to make our technology compatible with the technologies of third-party distribution partners who make our service available to our listeners through mobile devices, consumer electronic products and automobiles, we may not remain competitive and our business may fail to grow or decline.

In order to deliver music everywhere our listeners want to hear it, we need our service to be compatible with mobile, consumer electronic, automobile and website technologies. Our service is accessible in part through Pandora-developed or third-party developed applications that hardware manufacturers embed in, and distribute through, their devices. Connected devices and their underlying technology are constantly evolving. As internet connectivity of automobiles, mobile devices, and other consumer electronic products expands and as new internet-connected products are introduced, we must constantly adapt our technology. It is difficult to keep pace with the continual release of new devices and technological advances in digital media delivery and predict the problems we may encounter in developing versions of our applications for these new devices and delivery channels, and it may become increasingly challenging to do so in the future. In particular, the technology used for streaming the Pandora service in automobiles remains at an early stage and may not result in a seamless customer experience. If automobile and consumer electronic makers fail to make products that are compatible with our technology or we fail to adapt our technology to evolving requirements, our ability to grow or sustain the reach of our service, increase listener hours and sell advertising could be adversely affected.

Furthermore, consumer tastes and preferences can change in rapid and unpredictable ways and consumer acceptance of these products depends on the marketing, technical and other efforts of third-party manufacturers, which is beyond our control. If consumers fail to accept the products of the companies with whom we partner or if we fail to establish relationships with makers of leading consumer products, our business could be adversely affected.

We rely upon an agreement with DoubleClick, which is owned by Google, for delivering and monitoring our ads. Failure to renew the agreement on favorable terms, or termination of the agreement, could adversely affect our business.

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We use DoubleClick's ad-serving platform to deliver and monitor ads for our service. There can be no assurance that our agreement with DoubleClick, which is owned by Google, will be extended or renewed upon expiration, that we will be able to extend or renew our agreement with DoubleClick on terms and conditions

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favorable to us or that we could identify another alternative vendor to take its place. Our agreement with DoubleClick also allows DoubleClick to terminate our relationship before the expiration of the agreement on the occurrence of certain events, including if DoubleClick determines that our use of its service could damage or cause injury to DoubleClick or reflect unfavorably on DoubleClick's reputation.

Our independent registered public accounting firm has advised us that it has identified a material weakness in our internal control over financial reporting relating to inadequate financial statement preparation and review procedures.

In connection with the audit of our financial statements as of and for the year ended January 31, 2011 our independent registered public accounting firm reported to our audit committee that it had identified a material weakness in internal control over financial reporting related to inadequate financial statement preparation and review procedures. Under standards established by the Public Company Accounting Oversight Board, a material weakness is a deficiency, or combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected and corrected on a timely basis. Specifically, our independent registered public accounting firm determined that we did not have adequate procedures and controls to ensure that accurate financial statements could be prepared on a timely basis, including insufficient review of account reconciliations that did not identify exceptions or that required journal entries.

As a result of this material weakness, our auditors recommend that we:

implement and formalize written policies and procedures for the review of account analyses, reconciliations and journal entries;

assign account reconciliations and journal entries during the reporting period close process to specific individuals of our finance team;

formally document procedures performed during the review process;

implement enhanced oversight procedures to ensure that the account reconciliation review process has been performed prior to finalization of the financial statements at each reporting period;

formalize examination of closing period revenue and expenses cut-off procedures; and

formalize accounting evaluation of non-routine judgments and estimations.

We concurred with the findings of our independent registered public accounting firm. We are working to remediate the material weakness. We have begun taking numerous steps and plan to take additional steps to remediate the underlying causes of the material weakness, primarily through the development and implementation of formal policies, improved processes and documented procedures, as well as the hiring of additional accounting and finance personnel. The actions that we are taking are subject to ongoing senior management review, as well as audit committee oversight. Although we plan to complete this remediation process as quickly as possible, we cannot at this time estimate how long it will take, and our initiatives may not prove to be successful in remediating this material weakness. If we are unable to successfully remediate this material weakness and if we are unable to produce accurate and timely financial statements, our stock price may be adversely affected and we may be unable to maintain compliance with applicable stock exchange listing requirements.

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In addition, we will need to evaluate our internal controls over financial reporting in connection with Section 404 of the Sarbanes Oxley Act for fiscal 2012, and our auditors will be required to attest to our internal controls over financial reporting starting with our annual report for fiscal 2013. This assessment will need to include disclosure of any material weaknesses in our internal control over financial reporting identified by our management, as well as our auditors' attestation report on our internal controls over financial reporting. We are just beginning the costly and challenging process of compiling the system and processing documentation needed.

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to comply with such requirements. We may not be able to complete our evaluation, testing and any required remediation in a timely fashion. During the evaluation and testing processes, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal control over financial reporting is effective. If we are unable to assert that our internal control over financial reporting is effective, or if our auditors are unable to express an opinion on the effectiveness of our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have a material adverse effect on the price of our common stock.

Our business and prospects depend on the strength of our brand and failure to maintain and enhance our brand would harm our ability to expand our base of listeners, advertisers and other partners.

Maintaining and enhancing the Pandora brand is critical to expanding our base of listeners, advertisers and other partners. Maintaining and enhancing our brand will depend largely on our ability to continue to develop and provide an innovative and high quality experience for our listeners and attract advertisers, content owners and automobile, mobile device, and other consumer electronic product manufacturers to work with us, which we may not do successfully.

Our brand may be impaired by a number of other factors, including service outages, data privacy and security issues, listener perception of ad load and exploitation of our trademarks by others without permission. Further, if our partners fail to maintain high standards for products that integrate our service, fail to display our trademarks on their products in breach of our agreements with them, or use our trademarks incorrectly or in an unauthorized manner or if we partner with manufacturers of products that our listeners reject, the strength of our brand could be adversely affected. In addition, there is a risk that the word Pandora could become so commonly used that we lose protection for this trademark, which could result in other people using the word Pandora to refer to their own products, thus diminishing the strength of our brand.

We have not historically been required to spend considerable resources to establish and maintain our brand. However, if we are unable to maintain the growth rate in the number of our listeners, we may be required to expend greater resources on advertising, marketing, and other brand-building efforts to preserve and enhance consumer awareness of our brand which would adversely affect our operating results and may not be effective.

We have experienced rapid growth in recent periods. If we fail to effectively manage our growth, our business and operating results may suffer.

We have recently experienced, and expect to continue to experience, rapid growth which has placed, and will continue to place, significant demands on our management and our operational and financial infrastructure. We expect that our growth strategy will require us to commit substantial financial, operational and technical resources. In order to attain and maintain profitability, we will need to recruit, integrate and retain skilled and experienced sales personnel who can demonstrate our value proposition to advertisers and increase the monetization of listener hours, particularly on mobile devices. Continued growth could also strain our ability to maintain reliable service levels for our listeners, effectively monetize our listener hours, develop and improve our operational, financial and management controls, enhance our reporting systems and procedures and recruit, train and retain highly skilled personnel. If our systems do not evolve to meet the increased demands placed on us by an increasing number of advertisers, we may also be unable to meet our obligations under advertising agreements with respect to the timing of our delivery of advertising or other performance obligations. As our operations grow in size, scope and complexity, we will need to improve and upgrade our systems and infrastructure, which will require significant expenditures and allocation of valuable management resources. If we fail to maintain the necessary level of discipline and efficiency and allocate limited resources effectively in our organization as it grows, our business, operating results and financial condition will suffer.

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We depend on key personnel to operate our business, and if we are unable to retain, attract and integrate qualified personnel, our ability to develop and successfully grow our business could be harmed.

We believe that our future success is highly dependent on the contributions of our executive officers as well as our ability to attract and retain highly skilled and experienced sales, technical and other personnel. All of our employees, including our executive officers, are free to terminate their employment relationship with us at any time, and their knowledge of our business and industry may be difficult to replace. Qualified individuals are in high demand, particularly in the digital media industry, and we may incur significant costs to attract them. In addition, competition for qualified personnel is particularly intense in the San Francisco Bay Area, where our headquarters are located. If we are unable to attract and retain our executive officers and key employees, we may not be able to achieve our strategic objectives, and our business could be harmed. In addition, we believe that our key executives have developed highly successful and effective working relationships. If one or more of these individuals leave, we may not be able to fully integrate new executives or replicate the current dynamic and working relationships that have developed among our executive officers and other key personnel, and our operations could suffer.

Interruptions or delays in service arising from our own systems or from our third-party vendors could impair the delivery of our service and harm our business.

We rely on systems housed in our own facilities and upon third-party vendors, including bandwidth providers and data center facilities located in California and Virginia, to enable listeners to receive our content in a dependable, timely, and efficient manner. We have experienced and expect to continue to experience periodic service interruptions and delays involving our own systems and those of our third-party vendors. We do not currently maintain a live fail-over capability that would allow us to switch our streaming operations from one facility to another in the event of a service outage. Both our own facilities and those of our third-party vendors are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They also are subject to break-ins, sabotage, intentional acts of vandalism, the failure of physical, administrative, and technical security measures, terrorist acts, natural disasters, human error, the financial insolvency of our third-party vendors and other unanticipated problems or events. The occurrence of any of these events could result in interruptions in our service and to unauthorized access to, or alteration of, the content and data contained on our systems and that these third-party vendors store and deliver on our behalf.

We exercise no control over our third-party vendors, which makes us vulnerable to any errors, interruptions, or delays in their operations. Any disruption in the services provided by these vendors could have significant adverse impacts on our business reputation, customer relations and operating results. Upon expiration or termination of any of our agreements with third-party vendors, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, that are favorable to us, and a transition from one vendor to another vendor could subject us to operational delays and inefficiencies until the transition is complete.

Our operating results may fluctuate, which makes our results difficult to predict and could cause our results to fall short of expectations.

Our revenue and operating results could vary significantly from quarter to quarter and year to year because of a variety of factors, many of which are outside our control. As a result, comparing our operating results on a period to period basis may not be meaningful. In addition to other risk factors discussed in this Risk Factors section, factors that may contribute to the variability of our quarterly and annual results include:

our ability to retain our current listenership, build our listener base and increase listener hours;

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our ability to more effectively monetize mobile listener hours, particularly as the number of listener hours on mobile devices grow;

our ability to attract and retain existing advertisers and prove that our advertising products are effective enough to justify a pricing structure that is profitable for us;

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our ability to effectively manage our growth;

our ability to continue to operate under the statutory licenses set forth in the Copyright Act;

our ability to enjoy the benefit of rates negotiated below those established by the CRB in 2007;

our ability to enjoy the benefits of collective licensing available through performing rights organizations;

the effects of increased competition in our business;

our ability to keep pace with changes in technology and our competitors;

interruptions in service, whether or not we are responsible for such interruptions, and any related impact on our reputation;

costs associated with defending any litigation, including intellectual property infringement litigation;

our ability to pursue, and the timing of, entry into new geographic or content markets and, if pursued, our management of this expansion;

the impact of general economic conditions on our revenue and expenses; and

changes in government regulation affecting our business.

Seasonal variations in listener and advertising behavior may also cause fluctuations in our financial results. We expect to experience some effects of seasonal trends in listener behavior due to increased internet usage and sales of media-streaming devices during certain vacation and holiday periods. For example, we expect to experience increased usage during the fourth quarter of each calendar year due to the holiday season, and in the first quarter of each calendar year due to increased use of media-streaming devices received as gifts during the holiday season. We may also experience higher advertising sales during the fourth quarter of each calendar year due to greater advertiser demand during the holiday season. In addition, expenditures by advertisers tend to be cyclical and discretionary in nature, reflecting overall economic conditions, the economic prospects of specific advertisers or industries, budgeting constraints and buying patterns and a variety of other factors, many of which are outside our control. While we believe these seasonal trends have affected and will continue to affect our quarterly results, our trajectory of rapid growth may have overshadowed these effects to date. We believe that our business may become more seasonal in the future and that such seasonal variations in listener behavior may result in fluctuations in our financial results.

Failure to protect our intellectual property could substantially harm our business and operating results.

The success of our business depends on our ability to protect and enforce our trade secrets, trademarks, copyrights and patents and all of our other intellectual property rights, including our intellectual property rights underlying the Pandora service. We attempt to protect our intellectual property under trade secret, trademark, copyright and patent law, and through a combination of employee and third-party nondisclosure

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agreements, other contractual restrictions, and other methods. These afford only limited protection. Despite our efforts to protect our intellectual property rights and trade secrets, unauthorized parties may attempt to copy aspects of our song selection technology or obtain and use our trade secrets and other confidential information. Moreover, policing our intellectual property rights is difficult, costly and may not always be effective.

We have filed, and may in the future file, patent applications. It is possible, however, that these innovations may not be protectable. In addition, given the cost, effort, risks and downside of obtaining patent protection, including the requirement to ultimately disclose the invention to the public, we may choose not to seek patent protection for certain innovations. However, such patent protection could later prove to be important to our business. Furthermore, there is always the possibility that our patent applications may not issue as granted patents, that the scope of the protection gained will be insufficient or that an issued patent may be deemed invalid or unenforceable. We also cannot guarantee that any of our present or future patents or other intellectual property

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rights will not lapse or be invalidated, circumvented, challenged or abandoned, that our intellectual property rights will provide competitive advantages to us, that our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes will not be limited by our relationships with third parties, that any of our pending or future patent applications will have the coverage originally sought, that our intellectual property rights will be enforced in jurisdictions where competition may be intense or where legal protection may be weak, or that we will not lose the ability to assert our intellectual property rights against or to license our technology to others and collect royalties or other payments.

We have registered Pandora, Music Genome Project and other marks as trademarks in the United States. Nevertheless, competitors may adopt service names similar to ours, or purchase our trademarks and confusingly similar terms as keywords in internet search engine advertising programs, thereby impeding our ability to build brand identity and possibly leading to confusion among our listeners or advertising customers. In addition, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of the term Pandora or our other trademarks. Any claims or customer confusion related to our trademarks could damage our reputation and brand and substantially harm our business and operating results.

We currently own the www.pandora.com internet domain name and various other related domain names. Domain names are generally regulated by internet regulatory bodies. If we lose the ability to use a domain name in a particular country, we would be forced either to incur significant additional expenses to market our solutions within that country or to elect not to sell solutions in that country. Either result could harm our business and operating results. The regulation of domain names in the United States and in foreign countries is subject to change. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names that utilize our brand names in the United States or other countries in which we may conduct business in the future.

In order to protect our trade secrets and other confidential information, we rely in part on confidentiality agreements with our employees, consultants and third parties with whom we have relationships. These agreements may not effectively prevent disclosure of trade secrets and other confidential information and may not provide an adequate remedy in the event of misappropriation of trade secrets or any unauthorized disclosure of trade secrets and other confidential information. In addition, others may independently discover our trade secrets and confidential information, and in such cases we could not assert any trade secret rights against such parties. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our trade secret rights and related confidentiality and nondisclosure provisions, and failure to obtain or maintain trade secret protection, or our competitors' obtainment of our trade secrets or independent development of unpatented technology similar to ours or competing technologies, could adversely affect our competitive business position.

Litigation or proceedings before the U.S. Patent and Trademark Office or other governmental authorities and administrative bodies in the United States and abroad may be necessary in the future to enforce our intellectual property rights, to protect our patent rights, trademarks, trade secrets and domain names and to determine the validity and scope of the proprietary rights of others. Our efforts to enforce or protect our proprietary rights may be ineffective and could result in substantial costs and diversion of resources and management time, each of which could substantially harm our operating results.

Assertions by third parties of infringement or other violation by us of their intellectual property rights could result in significant costs and substantially harm our business and operating results.

Internet, technology and media companies are frequently subject to litigation based on allegations of infringement, misappropriation or other violations of intellectual property rights. Some internet, technology and media companies, including some of our competitors, own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims against us. Third parties have asserted, and may in the future

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assert, that we have infringed, misappropriated or otherwise violated their intellectual property rights, and as we face increasing competition, the possibility of intellectual property rights claims against us grows. For example, in April 2011, we were served with a complaint by Augme Technologies, Inc. alleging that we have infringed an Augme patent and seeking injunctive relief and monetary damages. Such litigation may involve patent holding companies or other adverse patent owners who have no relevant product revenue, and therefore our own issued and pending patents may provide little or no deterrence to these patent owners in bringing intellectual property rights claims against us. In addition, various federal and state laws and regulations govern the intellectual property rights associated with sound recordings and musical works. Existing laws and regulations are evolving and subject to different interpretations, and various federal and state legislative or regulatory bodies may expand current or enact new laws or regulations. We cannot assure you that we are not infringing or violating any third-party intellectual property rights.

We cannot predict whether assertions of third-party intellectual property rights or any infringement or misappropriation claims arising from such assertions will substantially harm our business and operating results. If we are forced to defend against any infringement or misappropriation claims, whether they are with or without merit, are settled out of court, or are determined in our favor, we may be required to expend significant time and financial resources on the defense of such claims. Furthermore, an adverse outcome of a dispute may require us to pay damages, potentially including treble damages and attorneys' fees, if we are found to have willfully infringed a party's intellectual property; cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others; expend additional development resources to redesign our solutions; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies, content, or materials; and to indemnify our partners and other third parties. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. In addition, any lawsuits regarding intellectual property rights, regardless of their success, could be expensive to resolve and would divert the time and attention of our management and technical personnel.

We may require additional capital to pursue our business objectives and respond to business opportunities, challenges or unforeseen circumstances. If capital is not available to us, our business, operating results and financial condition may be harmed.

We may require additional capital to operate or expand our business. In addition, some of our current or future strategic initiatives, including entry into non-music content channels, such as comedy, or international markets, may require substantial additional capital resources before they begin to generate revenue. Additional funds may not be available when we need them, on terms that are acceptable to us, or at all. For example, our current credit facility contains restrictive covenants relating to our capital raising activities and other financial and operational matters, and any debt financing secured by us in the future could involve further restrictive covenants, which may make it more difficult for us to obtain additional capital and to pursue business opportunities. In addition, volatility in the credit markets may have an adverse effect on our ability to obtain debt financing. If we do not have funds available to enhance our solutions, maintain the competitiveness of our technology and pursue business opportunities, we may not be able to service our existing listeners, acquire new listeners or attract or retain advertising customers, each of which could inhibit the implementation of our business plan and materially harm our operating results.

We may acquire other companies or technologies, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations and harm our operating results.

We may in the future seek to acquire or invest in businesses, products or technologies that we believe could complement or expand our service, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

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In addition, we do not have any experience in acquiring other businesses. If we acquire additional businesses, we may not be able to integrate the acquired personnel, operations and technologies successfully, or effectively manage the combined business following the acquisition. We also may not achieve the anticipated benefits from the acquired business due to a number of factors, including:

unanticipated costs or liabilities associated with the acquisition;

incurrence of acquisition-related costs;

diversion of management's attention from other business concerns;

harm to our existing business relationships with business partners and advertisers as a result of the acquisition;

harm to our brand and reputation;

the potential loss of key employees;

use of resources that are needed in other parts of our business; and

use of substantial portions of our available cash to consummate the acquisition.

In addition, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process.

Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial condition may suffer.

We face many risks associated with our long-term plan to expand our operations outside of the United States, including difficulties obtaining rights to stream music on favorable terms.

Expanding our operations into international markets is an element of our long-term strategy. However, offering our service outside of the United States involves numerous risks and challenges. Most importantly, while the Digital Performance Right in Sound Recordings Act and the Digital Millennium Copyright Act provide a statutory licensing regime for the streaming of sound recordings to listeners within the United States, there is no equivalent statutory licensing regime available outside of the United States, and the other licensing alternatives currently available are not commercially viable. Currently, the licensing terms offered by rights organizations and individual copyright owners in countries outside the United States are prohibitively expensive. Addressing licensing structure and royalty rate issues in the United States required us to make very substantial investments of time, capital and other resources, and our business could have failed if such investments had not succeeded. Addressing these issues in foreign jurisdictions may require a commensurate investment by us, and there can be no assurance that we would

succeed or achieve any return on this investment.

In addition, international expansion would expose us to other risks such as:

the need to modify our technology and sell our solutions in non-English speaking countries;

the need to localize our service to foreign customers' preferences and customs;

difficulties in managing operations due to language barriers, distance, staffing, cultural differences and business infrastructure constraints;

our lack of experience in marketing, and encouraging viral marketing growth without incurring significant marketing expenses, in foreign countries;

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application of foreign laws and regulations to us;

fluctuations in currency exchange rates;

reduced or ineffective protection of our intellectual property rights in some countries; and

potential adverse tax consequences associated with foreign operations and revenue.

Further, in jurisdictions where copyright protection has been insufficient to protect against widespread music piracy, achieving market acceptance of our service may prove difficult as we would need to convince listeners to stream our service when they could otherwise download the same music for free. As a result of these obstacles, we may find it impossible or prohibitively expensive to enter foreign markets, or entry into foreign markets could be delayed, which could hinder our ability to grow our business.

Expansion of our operations into non-music content, including our recent launch of comedy, subjects us to additional business, legal, financial and competitive risks.

Expansion of our operations into delivery of non-music content stations involves numerous risks and challenges, including increased capital requirements, new competitors and the need to develop new strategic relationships. For example, in May 2011, we started streaming spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization. Further, growth into this new area may require changes to our existing business model and cost structure, modifications to our infrastructure and exposure to new regulatory and legal risks, any of which may require expertise in which we have little or no experience. There is no guarantee that we will be able to generate sufficient revenue from advertising sales associated with comedy content to offset the costs of maintaining comedy stations. For example, many of the mainstream advertisers that choose to place ads on our music stations may choose not to advertise on our comedy stations because of the sometimes explicit nature of comedy content. Further, we have established a reputation as an online music provider and our ability to gain acceptance and listenership for comedy content stations, and thus our ability to attract advertisers on comedy stations, is not certain. Failure to obtain or retain rights to comedy content on acceptable terms, or at all, to successfully monetize and generate revenues from such content, or to effectively manage the numerous risks and challenges associated with such expansion could adversely affect our revenues and profitability. To the extent we choose, in the future, to offer additional types of content beyond music and comedy, such as news, talk and sports programming, we will be subject to many of these same risks.

Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited.

At January 31, 2011, we had federal net operating loss carryforwards of approximately \$79.6 million and tax credit carryforwards of approximately \$0.7 million. At January 31, 2011, we had state net operating loss carryforwards of approximately \$75.6 million and tax credit carryforwards of approximately \$1.8 million. Under Section 382/383 of the Internal Revenue Code of 1986, as amended, or the Code, if a corporation undergoes an ownership change, the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes, such as research tax credits, to offset its post-change income may be limited. In general, an ownership change will occur if there is a cumulative change in our ownership by 5-percent shareholders that exceeds 50 percentage points over a rolling three-year period. Similar rules may apply under state tax laws. As a result of prior equity issuances and other transactions in our stock, we have previously experienced ownership changes under section 382 of the Code and comparable state tax laws. We may also experience ownership changes in the future as a result of this issuance or future transactions in our stock. As a result, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards or other pre-change tax attributes to offset United States federal and state taxable income is subject to limitations.

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If we cannot maintain our corporate culture as we grow, we could lose the innovation, teamwork and focus that contribute crucially to our business.

We believe that a critical component of our success is our corporate culture, which we believe fosters innovation, encourages teamwork, cultivates creativity and promotes focus on execution. We have invested substantial time, energy and resources in building a highly collaborative team that works together effectively in a non-hierarchical environment designed to promote openness, honesty, mutual respect and pursuit of common goals. As we develop the infrastructure of a public company and continue to grow, we may find it difficult to maintain these valuable aspects of our corporate culture. Any failure to preserve our culture could negatively impact our future success, including our ability to attract and retain employees, encourage innovation and teamwork and effectively focus on and pursue our corporate objectives.

Federal, state and industry regulations as well as self-regulation related to privacy and data security concerns pose the threat of lawsuits and other liability, require us to expend significant resources, and may hinder our ability and our advertisers' ability to deliver relevant advertising.

We collect and utilize demographic and other information, including personally identifiable information, from and about our listeners as they interact with our service. For example, to register for a Pandora account, our listeners must provide the following information: age, gender, zip code and e-mail address. Listeners must also provide their credit card or debit card numbers and other billing information in connection with additional service offerings. We also may collect information from our listeners when they enter information on their profile page, post comments on other listeners' pages, use other community or social networking features that are part of our service, participate in polls or contests or sign up to receive e-mail newsletters. Further, we and third parties use tracking technologies, including cookies and related technologies, to help us manage and track our listeners' interactions with our service and deliver relevant advertising.

Various federal and state laws and regulations govern the collection, use, retention, sharing and security of the data we receive from and about our listeners. Privacy groups and government bodies have increasingly scrutinized the ways in which companies link personal identities and data associated with particular users or devices with data collected through the internet, and we expect such scrutiny to continue to increase. Alleged violations of laws and regulations relating to privacy and data security, and any relevant claims, may expose us to potential liability and may require us to expend significant resources in responding to and defending such allegations and claims. For example, in late 2010 and early 2011, we were named as a defendant in several class action lawsuits alleging, among other things, violations of computer fraud, computer trespass and privacy laws. In addition, in early 2011, we were served with a subpoena to produce documents in connection with a federal grand jury, which we believe was convened to investigate the information sharing processes of certain popular applications that run on the Apple and Android mobile platforms. While we were informed that we are not a specific target of the investigation, and we believe that similar subpoenas were issued on an industry-wide basis to the publishers of numerous other smartphone applications, we will likely incur legal costs related to compliance with the subpoena, management's attention could be diverted and there is no guarantee that we will avoid costly litigation. Claims or allegations that we have violated laws and regulations relating to privacy and data security have resulted and could in the future result in negative publicity and a loss of confidence in us by our listeners and our advertisers, and may subject us to fines by credit card companies and loss of our ability to accept credit and debit card payments.

Existing privacy-related laws and regulations are evolving and subject to potentially differing interpretations, and various federal and state legislative and regulatory bodies may expand current or enact new laws regarding privacy and data security-related matters. We may find it necessary or desirable to join self-regulatory bodies or other privacy-related organizations that require compliance with their rules pertaining to privacy and data security. We also may be bound by contractual obligations that limit our ability to collect, use, disclose, and leverage listener data and to derive economic value from it. New laws, amendments to or re-interpretations of existing laws, rules of self-regulatory bodies, industry standards and contractual obligations,

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as well as changes in our listeners' expectations and demands regarding privacy and data security, may limit our ability to collect, use, and disclose, and to leverage and derive economic value from listener data. We may also be required to expend significant resources to adapt to these changes and to develop new ways to deliver relevant advertising or otherwise provide value to our advertisers. In particular, government regulators have proposed "do not track" mechanisms, and requirements that users affirmatively "opt-in" to certain types of data collection that, if enacted into law or adopted by self-regulatory bodies or as part of industry standards, could significantly hinder our ability to collect and use data relating to listeners. Restrictions on our ability to collect, access and harness listener data, or to use or disclose listener data or any profiles that we develop using such data, would in turn limit our ability to stream personalized music content to our listeners and offer targeted advertising opportunities to our advertising customers, each of which are critical to the success of our business.

We have incurred, and will continue to incur, expenses to comply with privacy and security standards and protocols imposed by law, regulation, self-regulatory bodies, industry standards and contractual obligations. Increased regulation of data utilization and distribution practices, including self-regulation and industry standards, could increase our cost of operation, limit our ability to grow our operations or otherwise adversely affect our business.

If our security systems are breached, we may face civil liability and public perception of our security measures could be diminished, either of which would negatively affect our ability to attract listeners and advertisers.

Techniques used to gain unauthorized access are constantly evolving, and we may be unable to anticipate or prevent unauthorized access to data pertaining to our listeners, including credit card and debit card information and other personally identifiable information. If an actual or perceived breach of security occurs of our systems or a vendor's systems, we may face civil liability and public perception of our security measures could be diminished, either of which would negatively affect our ability to attract listeners, which in turn would harm our efforts to attract and retain advertisers. We also would be required to expend significant resources to mitigate the breach of security and to address related matters.

We cannot control the actions of third parties who may have access to the listener data we collect. The integration of the Pandora service with applications provided by third parties represents a significant growth opportunity for us, but we may not be able to control such third parties' use of listeners' data, ensure their compliance with the terms of our privacy policies, or prevent unauthorized access to, or use or disclosure of, listener information, any of which could hinder or prevent our efforts with respect to growth opportunity.

Any failure, or perceived failure, by us to maintain the security of data relating to our listeners and employees, to comply with our posted privacy policy, laws and regulations, rules of self-regulatory organizations, industry standards, and contractual provisions to which we may be bound, could result in the loss of confidence in us, or result in actions against us by governmental entities or others, all of which could result in litigation and financial losses, and could potentially cause us to lose listeners, advertisers, revenue, and employees.

We are subject to a number of risks related to credit card and debit card payments we accept.

We accept payments exclusively through credit and debit card transactions. For credit and debit card payments, we pay interchange and other fees, which may increase over time. An increase in those fees would require us to either increase the prices we charge for our products, which could cause us to lose subscribers and subscription revenue, or suffer an increase in our operating expenses, either of which could harm our operating results.

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If we or any of our processing vendors have problems with our billing software, or the billing software malfunctions, it could have an adverse effect on our subscriber satisfaction and could cause one or more of the major credit card companies to disallow our continued use of their payment products. In addition, if our billing

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software fails to work properly and, as a result, we do not automatically charge our subscribers' credit cards on a timely basis or at all, we could lose subscription revenue, which would harm our operating results.

We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it more difficult for us to comply. Currently, we are assessing whether we are fully compliant with the Payment Card Industry, or PCI, Data Security Standard, or PCI DSS, a security standard with which companies that collect, store, or transmit certain data regarding credit and debit cards, credit and debit card holders, and credit and debit card transactions are required to comply. Our failure to comply fully with PCI DSS may violate payment card association operating rules, federal and state laws and regulations, and the terms of our contracts with payment processors and merchant banks. Such failure to comply fully also may subject us to fines, penalties, damages, and civil liability, and may result in the loss of our ability to accept credit and debit card payments. Further, there is no guarantee that, even if PCI DSS compliance is achieved, we will maintain PCI DSS compliance or that such compliance will prevent illegal or improper use of our payment systems or the theft, loss, or misuse of data pertaining to credit and debit cards, credit and debit card holders and credit and debit card transactions.

If we fail to adequately control fraudulent credit card transactions, we may face civil liability, diminished public perception of our security measures and significantly higher credit card-related costs, each of which could adversely affect our business, financial condition and results of operations.

If we are unable to maintain our chargeback rate or refund rates at acceptable levels, credit card and debit card companies may increase our transaction fees or terminate their relationships with us. Any increases in our credit card and debit card fees could adversely affect our results of operations, particularly if we elect not to raise our rates for our service to offset the increase. The termination of our ability to process payments on any major credit or debit card would significantly impair our ability to operate our business.

If we fail to detect click fraud or other invalid clicks on ads, we could lose the confidence of our advertisers, which would cause our business to suffer.

Our business relies on delivering positive results to our advertising customers. We are exposed to the risk of fraudulent and other invalid clicks or conversions that advertisers may perceive as undesirable. A major source of invalid clicks could result from click fraud where a listener intentionally clicks on ads for reasons other than to access the underlying content of the ads. If fraudulent or other malicious activity is perpetrated by others and we are unable to detect and prevent it, or if we choose to manage traffic quality in a way that advertisers find unsatisfactory, the affected advertisers may experience or perceive a reduced return on their investment in our advertising products, which could lead to dissatisfaction with our advertising programs, refusals to pay, refund demands or withdrawal of future business. This could damage our brand and lead to a loss of advertisers and revenue.

Our success depends on our listeners' continued high-speed access to the internet and wireless devices and the continued reliability of the related infrastructure.

Because our service is designed primarily to work over the internet, our revenue growth depends on our listeners' low cost, high-speed access to the internet, as well as the continued maintenance and development of the internet infrastructure, including the wireless internet infrastructure. The future delivery of our service will depend on third-party internet service providers and wireless telecommunication companies expanding high-speed internet access and wireless networks, maintaining reliable networks with the necessary speed, data capacity and security, and developing complementary products and services for providing reliable and timely wired and wireless internet access and services. The success

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of our business depends directly on the continued accessibility, maintenance and improvement of the internet and, in particular, access to the internet through wireless infrastructure, to permit high-quality streaming of content and provide a convenient and reliable platform for customer interaction. All of these factors are outside of our control.

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To the extent that the internet and the wireless internet infrastructure continue to experience an increasing number of listeners, frequency of use and expanding bandwidth requirements, the internet and wireless networks may become congested and unable to support the demands placed on them, and their performance and reliability may decline. In addition, the wireless communications companies that provide our listeners with access to the internet through wireless networks may raise their rates or impose data usage limits, which could cause our listeners to decrease their usage of our service or our listenership to decline. Any future internet or wireless network outages, interruptions, bandwidth constraints, rate increases or data usage limits could adversely affect our ability to provide service to our listeners and advertising customers.

Some of our services and technologies may use open source software, which may restrict how we use or distribute our service or require that we release the source code of certain services subject to those licenses.

Some of our services and technologies may incorporate software licensed under so-called open source licenses, including, but not limited to, the GNU General Public License and the GNU Lesser General Public License. Such open source licenses typically require that source code subject to the license be made available to the public and that any modifications or derivative works to open source software continue to be licensed under open source licenses. Few courts have interpreted open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to some uncertainty. We rely on multiple software programmers to design our proprietary technologies, and we do not exercise complete control over the development efforts of our programmers and we cannot be certain that our programmers have not incorporated open source software into our proprietary products and technologies or that they will not do so in the future. In the event that portions of our proprietary technology are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code, re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce or eliminate the value of our services and technologies and materially and adversely affect our ability to sustain and grow our business.

Government regulation of the internet is evolving, and unfavorable developments could have an adverse effect on our operating results.

We are subject to general business regulations and laws, as well as regulations and laws specific to the internet. Such laws and regulations cover taxation, user privacy, data collection and protection, copyrights, electronic contracts, sales procedures, automatic subscription renewals, credit card processing procedures, consumer protections, broadband internet access and content restrictions. We cannot guarantee that we have been or will be fully compliant in every jurisdiction, as it is not entirely clear how existing laws and regulations governing issues such as privacy, taxation and consumer protection apply to the internet. Moreover, as internet commerce continues to evolve, increasing regulation by federal, state and foreign agencies becomes more likely. The adoption of any laws or regulations that adversely affect the popularity or growth in use of the internet, including laws limiting internet neutrality, could decrease listener demand for our service offerings and increase our cost of doing business. Future regulations, or changes in laws and regulations or their existing interpretations or applications, could also hinder our operational flexibility, raise compliance costs and result in additional historical or future liabilities for us, resulting in adverse impacts on our business and our operating results.

We could be adversely affected by regulatory restrictions on the use of mobile and other electronic devices in motor vehicles, and legal claims are possible from use of such devices while driving.

Regulatory and consumer agencies have increasingly focused on distraction to drivers that may be associated with use of mobile and other devices in motor vehicles. In 2010, the U.S. Department of Transportation identified driver distraction as a top priority, and we anticipate new regulatory activity in this area. Regulatory restrictions on how drivers and passengers in automobiles may engage with devices on which our service is broadcast could inhibit our ability to increase listener hours and generate ad revenue, which would harm our operating results. In addition, concerns over driver distraction due to use of mobile and other electronic devices to access our service in motor vehicles could result in litigation and negative publicity.

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We rely on third parties to provide software and related services necessary for the operation of our business.

We incorporate and include third-party software into and with our applications and service offerings and expect to continue to do so. The operation of our applications and service offerings could be impaired if errors occur in the third-party software that we use. It may be more difficult for us to correct any defects in third-party software because the development and maintenance of the software is not within our control. Accordingly, our business could be adversely affected in the event of any errors in this software. There can be no assurance that any third-party licensors will continue to make their software available to us on acceptable terms, to invest the appropriate levels of resources in their software to maintain and enhance its capabilities, or to remain in business. Any impairment in our relationship with these third-party licensors could harm our ability to maintain and expand the reach of our service, increase listener hours and sell advertising each of which could harm our operating results, cash flow and financial condition.

The impact of worldwide economic conditions, including the effect on advertising budgets and discretionary entertainment spending behavior, may adversely affect our business and operating results.

Our financial condition is affected by worldwide economic conditions and their impact on advertising spending. Expenditures by advertisers generally tend to reflect overall economic conditions, and to the extent that the economy continues to stagnate, reductions in spending by advertisers could have a serious adverse impact on our business. In addition, we provide an entertainment service, and payment for our Pandora One subscription service or payment of fees to receive our service once a listener reaches 40 hours use per month on a traditional computer may be considered discretionary on the part of some of our current and prospective subscribers or listeners, who may choose to use a competing free service. To the extent that overall economic conditions reduce spending on discretionary activities, our ability to retain current and obtain new subscribers could be hindered, which could reduce our subscription revenue and negatively impact our business.

Our business is subject to the risks of earthquakes, fires, floods and other natural catastrophic events and to interruption by man-made problems such as computer viruses or terrorism.

Our systems and operations are vulnerable to damage or interruption from earthquakes, fires, floods, power losses, telecommunications failures, terrorist attacks, acts of war, human errors, break-ins or similar events. For example, a significant natural disaster, such as an earthquake, fire or flood, could have a material adverse impact on our business, operating results and financial condition, and our insurance coverage may be insufficient to compensate us for losses that may occur. Our principal executive offices are located in the San Francisco Bay Area, a region known for seismic activity. In addition, acts of terrorism could cause disruptions in our business or the economy as a whole. Our servers may also be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems, which could lead to interruptions, delays, loss of critical data or the unauthorized disclosure of confidential customer data. We currently have very limited disaster recovery capability, and our business interruption insurance may be insufficient to compensate us for losses that may occur. As we rely heavily on our servers, computer and communications systems and the internet to conduct our business and provide high quality service to our listeners, such disruptions could negatively impact our ability to run our business, result in loss of existing or potential listeners and advertisers and increased maintenance costs, which would adversely affect our operating results and financial condition.

Risks Related to this Offering and Owning Our Common Stock

An active, liquid and orderly market for our common stock may not develop or be sustained, the trading prices of our common stock may be volatile and you may be unable to sell your shares at or above the offering price.

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Prior to this offering, there has been no public market for shares of our common stock. An active trading market for our common stock may not develop or be sustained, which could depress the market price of our common stock and could affect your ability to sell your shares. The initial public offering price will be determined through negotiations between us and the representatives of the underwriters and may bear no

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relationship to the price at which our common stock will trade following the completion of this offering. The trading price of our common stock following this offering could be subject to wide fluctuations in response to the risk factors described in this prospectus and others beyond our control including:

our actual or anticipated operating performance and the operating performance of similar companies in the internet, radio or digital media spaces;

general economic conditions and their impact on advertising spending;

the overall performance of the equity markets;

the number of shares of our common stock publicly owned and available for trading;

threatened or actual litigation;

changes in laws or regulations relating to our service;

any major change in our board of directors or management;

publication of research reports about us or our industry or changes in recommendations or withdrawal of research coverage by securities analysts; and

sales or expected sales of shares of our common stock by us, and our officers, directors and significant stockholders.

In addition, the stock market has experienced extreme price and volume fluctuations that often have been unrelated or disproportionate to the operating performance of those companies. These fluctuations may be even more pronounced in the trading market for our stock shortly following this offering. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. Such litigation, if instituted against us, could result in very substantial costs, divert our management's attention and resources and harm our business, operating results and financial condition.

Sales of substantial amounts of our common stock in the public markets, or the perception that they might occur, could reduce the price that our common stock might otherwise attain and may dilute your voting power and your ownership interest in us.

Sales of substantial amounts of our common stock in the public market following our initial public offering, or the perception that such sales could occur, could adversely affect the market price of our common stock and may make it more difficult for you to sell your common stock at a time and price that you deem appropriate. Based on the number of shares outstanding as of April 30, 2011, upon the closing of this offering, we will have outstanding 159,727,692 shares of common stock (or 161,930,292 shares of common stock if the underwriters exercise in full their over-allotment option). The shares of our common stock that we are selling in this offering may be resold immediately in the public market unless they are held by affiliates, as that term is defined in Rule 144 of the Securities Act.

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Subject to certain exceptions described under the caption "Underwriters," we and all of our directors and officers and substantially all of our equityholders have agreed not to offer, sell or agree to sell, directly or indirectly, any shares of common stock without the permission of the representatives of the underwriters for a period of 180 days from the date of this prospectus. When the lock-up period expires, we and our locked-up security holders will be able to sell our shares in the public market. In addition, the underwriters may, in their sole discretion, release all or some portion of the shares subject to lock-up agreements prior to expiration of the lock-up period. See the section of this prospectus captioned "Shares Eligible for Future Sale" for more information. Sales of a substantial number of such shares upon expiration, or the perception that such sales may occur, or early release, of the lock-up could cause our share price to fall or make it more difficult for you to sell your common stock at a time and price that you deem appropriate.

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Holders of approximately 136,000,451 shares, or 85.1%, of our common stock will have rights, subject to some conditions, to require us to file registration statements covering the sale of their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. We also intend to register the offer and sale of all shares of common stock that we may issue under our equity compensation plans. Once we register the offer and sale of shares for the holders of registration rights and option holders, they can be freely sold in the public market upon issuance, subject to the lock-up agreements described in the section of this prospectus captioned "Underwriters" or unless they are held by affiliates, as that term is defined in Rule 144 of the Securities Act.

We also may issue our shares of common stock or securities convertible into our common stock from time to time in connection with a financing, acquisition, investments or otherwise. Any such issuance could result in substantial dilution to our existing stockholders and cause the trading price of our common stock to decline.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that securities or industry analysts publish about us or our business. Securities and industry analysts do not currently, and may never, publish research focused on our company. If no securities or industry analysts commence coverage of our company, the price and trading volume of our stock likely would be negatively impacted. If securities or industry analysts initiate coverage, and one or more of the analysts who cover us downgrade our stock or publish inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.

Our management will have broad discretion over the use of the proceeds we receive in this offering and may not apply the proceeds in ways that increase the value of your investment.

Our management generally will have broad discretion to use the net proceeds to us from this offering, and you will be relying on the judgment of our management regarding the application of these proceeds. Our management might not apply the net proceeds from this offering in ways that increase the value of your investment. Except as described in the section of this prospectus captioned "Use of Proceeds," we have not allocated the net proceeds from this offering for any specific purposes. Until we use the net proceeds to us from this offering, we plan to invest them, and these investments may not yield a favorable rate of return. If we do not invest or apply the net proceeds from this offering in ways that enhance stockholder value, we may fail to achieve expected financial results, which could cause our stock price to decline.

Because some existing stockholders will together beneficially own approximately 72.0% of our outstanding stock after this offering, the voting power of other stockholders, including purchasers in this offering, will be effectively limited.

After this offering, it is anticipated that our officers, directors, greater than 5% stockholders and their affiliates will beneficially own or control, directly or indirectly, 115,060,573 shares of common stock, which in the aggregate will represent approximately 72.0% of the outstanding shares of common stock, assuming no exercise of the underwriters' over-allotment option. As a result, if some of these persons or entities act together, they will have significant influence over the outcome of matters submitted to our stockholders for approval, including the election of directors. This may delay or prevent an acquisition or cause the market price of our stock to decline. Some of these persons or entities may have interests different from yours. For example, because many of these stockholders purchased their shares at prices substantially below the price at which shares are being sold in this offering and have held their shares for a relatively longer period, they may be more interested in selling the company to an acquiror than other investors or may want us to pursue strategies that are different from the wishes of other investors.

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Our charter documents, Delaware law and certain terms of our music licensing arrangements could discourage takeover attempts and lead to management entrenchment.

Our certificate of incorporation and bylaws that will be in effect upon the closing of this offering contain provisions that could delay or prevent a change in control of our company. These provisions could also make it difficult for stockholders to elect directors that are not nominated by the current members of our board of directors or take other corporate actions, including effecting changes in our management. These provisions include:

a classified board of directors with three-year staggered terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;

no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;

the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquiror;

the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of our board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

the requirement that a special meeting of stockholders may be called only by the chairman of our board of directors, our president, our secretary, or a majority vote of our board of directors, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;

the requirement for the affirmative vote of holders of at least 66 2/3% of the voting power of all of the then outstanding shares of the voting stock, voting together as a single class, to amend the provisions of our certificate of incorporation relating to the issuance of preferred stock and management of our business or our bylaws, which may inhibit the ability of an acquiror to effect such amendments to facilitate an unsolicited takeover attempt;

the ability of our board of directors, by majority vote, to amend the bylaws, which may allow our board of directors to take additional actions to prevent an unsolicited takeover and inhibit the ability of an acquiror to amend the bylaws to facilitate an unsolicited takeover attempt; and

advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

Section 203 of the Delaware General Corporation Law governs us. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time. In addition, if we are acquired, certain terms of our music licensing arrangements, including favorable royalty rates, that currently apply to us may not be available to an

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acquiror. These terms may discourage a potential acquiror from making an offer to buy us or may reduce the price such a party may be willing to offer.

Investors purchasing common stock in this offering will experience immediate and substantial dilution.

Purchasers of our common stock in this offering will incur immediate and substantial dilution of \$15.39 per share in the net tangible book value of our common stock based upon an initial public offering price of \$16.00 per share. This dilution is due in large part to earlier investors having paid substantially less than the initial public

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offering price when they purchased their shares. Investors purchasing shares of common stock in this offering will contribute approximately 41% of the total amount we have raised since our inception, but will own only approximately 4% of our total common stock immediately following the completion of this offering. As a result, investors who will control a majority of our outstanding stock will have substantially lower cost basis in their stock than investors in this offering, and as such may have interests that differ from investors in this offering. To the extent outstanding stock options and warrants are ultimately exercised, there will be further dilution to investors in this offering. In addition, if the underwriters exercise their over-allotment option to purchase additional shares from us, investors in this offering will experience additional dilution. See the section captioned "Dilution" for additional information.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND INDUSTRY DATA

This prospectus contains forward-looking statements about us and our industry that involve substantial risks and uncertainties. All statements, other than statements of historical fact, included in this prospectus regarding our strategy, future operations, future financial position, future revenue, projected expenses, prospects and plans and objectives of management are forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievement to be materially different from those expressed or implied by the forward-looking statements. Forward-looking statements in this prospectus include, but are not limited to, statements about:

our financial performance, including our revenue, cost of revenue, operating expenses and ability to attain and sustain profitability;

our ability to generate additional revenue on a cost-effective basis;

our ability to attract and retain advertisers;

the market for online and mobile advertising;

trends in music and radio consumption;

our ability to attract and retain subscribers;

our ability to increase our listener base and listener hours;

our ability to compete for listeners and advertising spending with other content services;

our ability to continue operating under existing laws and licensing regimes;

our ability to license music at favorable royalty rates;

our ability to expand our service to new mobile, consumer electronics and automotive platforms;

our plans to expand our service to new content formats;

our ability to retain and hire necessary employees;

the impact of seasonality on our business;

our ability to adequately protect our intellectual property;

our liquidity and working capital requirements;

our long-term international expansion plans;

our ability to stay abreast of modified or new laws and regulations applying to our business, including copyright and privacy regulation; and

worldwide economic conditions and their impact on advertising spending.

In some cases, you can identify forward-looking statements by terms such as anticipate, believe, estimate, expect, intend, may, might, project, will, would, should, could, can, predict, potential, continue, objective, or the negative of these terms, and similar expressions to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management's beliefs and assumptions only as of the date of this prospectus. You should read this prospectus, the documents that we have filed as exhibits to the registration statement of which this prospectus is a part, and any related free writing prospectus completely and with the understanding that our actual future results may be materially different from what we expect.

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Some of the industry and market data contained in this prospectus are based on independent industry publications, including those generated by Ando, Arbitron, comScore, IDC, Nielsen, SNL Kagan, Radio Advertising Bureau and VSS or other publicly available information. This information involves a number of assumptions and limitations. Although we believe that each source is reliable as of its respective date, neither we nor the underwriters have independently verified the accuracy or completeness of this information. The industry in which we operate is subject to a high degree of uncertainty and risk due to variety of factors, including those described in the section entitled "Risk Factors." These and other factors could cause results to differ materially from those expressed in these publications. We qualify all of our forward-looking statements by these cautionary statements.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of the shares of common stock that we are offering will be approximately \$85.5 million, or approximately \$118.3 million if the underwriters' over-allotment option is exercised in full, based upon our initial public offering price of \$16.00 per share and after deducting underwriters' discounts and commissions and estimated offering expenses payable by us. We will not receive any of the proceeds from the sale of common stock by the selling stockholders.

We intend to use a portion of the net proceeds of this offering to pay accrued and unpaid dividends on our redeemable convertible preferred stock in connection with the automatic conversion of such redeemable convertible preferred stock into common stock upon the closing of this offering. The amount of such accrued dividends will be equal to (1) approximately \$29.7 million, which is the amount of accrued dividends if the closing had occurred on April 30, 2011, plus (2) approximately \$26,000 per day for the period from April 30, 2011 to the date of the closing. We intend to use the remaining net proceeds from this offering for general corporate purposes, including working capital. If the opportunity arises, we may also use a portion of the net proceeds to acquire, invest in, or obtain rights to, complementary technologies, products, services or businesses. We are not currently a party to any agreements or commitments for any such transactions, and we have no current understandings with respect to any such transactions.

Management's plans for the proceeds of this offering are subject to change due to unforeseen events and opportunities, and the amounts and timing of our actual expenditures depend on several factors, including our expansion plans and the amount of cash generated or used by our operations. We cannot specify with certainty the particular uses for the net proceeds to be received upon the closing of this offering. Accordingly, our management team will have broad discretion in using the net proceeds of this offering. Pending the use of the net proceeds, we intend to invest the net proceeds in short-term, investment-grade, interest-bearing instruments.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our capital stock and, except as set forth under the caption "Use of Proceeds," currently do not anticipate paying any cash dividends after the offering and for the foreseeable future. Instead, we intend to retain all available funds and any future earnings for us in the operation and expansion of our business. Any future determination relating to dividend policy will be made at the discretion of our board of directors and will depend on our future earnings, capital requirements, financial condition, future prospects, applicable Delaware law, which provides that dividends are only payable out of surplus or current net profits, and other factors that our board of directors deems relevant. In addition, our credit facility restricts our ability to pay dividends. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Our Indebtedness—Credit Facility" and note 7 to our financial statements included elsewhere in this prospectus.

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The following table summarizes our cash and cash equivalents and capitalization as of April 30, 2011:

on an actual basis; and

on a pro forma, as adjusted basis, giving effect to (1) the automatic conversion of all outstanding redeemable convertible preferred stock into an aggregate of 137,294,574 shares of common stock upon the closing of this offering, (2) the reclassification of outstanding warrants to purchase redeemable convertible preferred stock into warrants to purchase 154,938 shares of common stock upon the closing of this offering, (3) our receipt of the net proceeds from the sale by us in this offering of shares of common stock at the initial public offering price of \$16.00 per share, after deducting underwriting discounts and commissions and estimated offering expenses payable by us, (4) our receipt of the proceeds from the exercise of stock options and warrants to purchase 1,205,977 shares of common stock that will be sold in this offering and (5) the application of the net proceeds we will receive from this offering in the manner described in Use of Proceeds.

The information below is illustrative only and our capitalization following the closing of this offering will be adjusted based on the actual initial public offering price and other terms of this offering determined at pricing. You should read the following table in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, Description of Capital Stock, and the Financial Statements and notes thereto appearing elsewhere in this prospectus.

	As of April 30, 2011	
	Actual	Pro Forma, as Adjusted
	(unaudited)	
	(in thousands, except per share data)	
Cash and cash equivalents	\$ 43,718	\$ 101,937
Current and long-term debt	\$ 7,433	\$ 7,433
Preferred stock warrant liabilities	2,550	
Redeemable convertible preferred stock, \$0.0001 par value: 134,051,713 shares authorized and 133,534,334 shares issued and outstanding, actual; no shares authorized and no shares issued and outstanding, pro forma as adjusted	128,757	
Stockholders' equity (deficit):		
Common stock, \$0.0001 par value; 220,000,000 shares authorized and 15,226,459 shares issued and outstanding, actual; 1,000,000,000 shares authorized and 159,727,692 shares issued and outstanding, pro forma as adjusted	2	16
Additional paid-in capital	1,304	188,725
Accumulated deficit	(92,073)	(92,073)
Total stockholders' equity (deficit)	(90,767)	96,668
Total capitalization	\$ 47,973	\$ 104,101

The number of shares of our common stock to be outstanding after this offering is based on 152,521,033 shares outstanding as of April 30, 2011 and excludes:

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36,675,288 shares of common stock issuable upon the exercise of outstanding options to purchase our common stock at a weighted average exercise price of approximately \$1.35 per share;

154,938 shares of common stock issuable upon exercise of warrants at a weighted average exercise price of \$0.77 per share;

1,369,357 shares of common stock reserved for issuance under our existing stock option plan; and

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12,000,000 shares of our common stock reserved for issuance under our 2011 Long-Term Incentive Plan, plus annual increases thereunder, as described in the section captioned Executive Compensation-Employee Benefit Plans-2011 Long-Term Incentive Plan.

Table of Contents**DILUTION**

If you invest in our common stock, you will experience immediate and substantial dilution in the pro forma as adjusted net tangible book value per share of our common stock after this offering.

Dilution will result from the fact that the per share offering price of our common stock is substantially in excess of the book value per share attributable to the existing stockholders for our currently outstanding common stock.

The pro forma net tangible book value of our common stock as of April 30, 2011 was \$10.9 million, or \$0.07 per share. Pro forma net tangible book value per share represents our total tangible assets (total assets less intangible assets) less total liabilities divided by the number of shares of outstanding common stock, after giving effect to (1) the automatic conversion of our redeemable convertible preferred stock in connection with this offering and (2) the reclassification of outstanding warrants to purchase shares of our redeemable convertible preferred stock into warrants to purchase 403,298 shares of common stock upon the closing of this offering. The pro forma, as adjusted net tangible book value of our common stock as of April 30, 2011 would have been \$96.7 million, or \$0.61 per share, after giving effect to (1) the sale of 6,000,682 shares of common stock in this offering at an initial public offering price of \$16.00 per share, after deducting underwriting discounts and commissions and estimated offering expenses payable by us, (2) our receipt of the proceeds from the exercise of stock options and warrants to purchase 1,205,977 shares of common stock that will be sold in this offering and (3) the application of the net proceeds we will receive from this offering in the manner described in Use of Proceeds. This represents an immediate increase in pro forma as adjusted net tangible book value of \$0.54 per share to existing stockholders and an immediate dilution of \$15.39 per share to new investors purchasing shares in the offering. The following table illustrates this dilution on a per share basis to new investors:

Initial public offering price per share	\$ 16.00
Pro forma net tangible book value per share as of April 30, 2011	\$ 0.07
Increase per share attributable to new investors in this offering	0.54
Pro forma as adjusted net tangible book value per share after this offering	0.61
Dilution in pro forma as adjusted net tangible book value per share to new investors	\$ 15.39

Dilution is determined by subtracting pro forma net tangible book value per share after the offering from the initial offering price per share.

The following table summarizes, as of April 30, 2011, the number of shares of common stock purchased from us, the total consideration paid, or to be paid, and the average price per share paid, or to be paid, by existing stockholders and by the new investors, at an initial public offering price of \$16.00 per share before deducting estimated underwriting discounts and commissions and offering expenses payable by us.

	Shares Purchased		Total Consideration		Average Price per Share
	Number	Percent	Amount	Percent	
Existing stockholders	153,727,010	96%	\$ 136,670,211	59%	\$ 0.89
New investors	6,000,682	4	96,010,912	41	16.00
Total	159,727,692	100%	\$ 232,681,123	100%	\$ 1.46

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If the underwriters' over-allotment option is exercised in full, the number of shares held by the new investors will be increased to 8,203,282, or approximately 5.1% of the total number of shares of our common stock outstanding after this offering.

Sales by the selling stockholders in this offering will reduce the number of shares held by existing stockholders to 145,043,692 or approximately 90.8% of the total shares of our common stock outstanding after this offering, or 89.6% of the total shares of our common stock outstanding after this offering if the over-

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allotment option is exercised in full. The number of shares to be purchased by new investors will be increased to 14,684,000 shares or approximately 9.2% of the total shares of our common stock outstanding after this offering, or 16,886,600 shares or approximately 10.4% of the total shares of common stock outstanding after this offering, if the over-allotment option is exercised.

The foregoing discussion and tables are based on 152,521,033 shares of common stock issued and outstanding as of April 30, 2011, and excludes:

36,675,288 shares of common stock issuable upon the exercise of outstanding options to purchase our common stock at a weighted average exercise price of approximately \$1.35 per share;

154,938 shares of common stock issuable upon exercise of warrants at a weighted average exercise price of \$0.77 per share;

1,369,357 shares of common stock reserved for issuance under our existing stock option plan; and

12,000,000 shares of our common stock reserved for issuance under our 2011 Long-Term Incentive Plan, plus annual increases thereunder, as described in the section captioned Executive Compensation-Employee Benefit Plans-2011 Long-Term Incentive Plan.

To the extent that any outstanding options or warrants are exercised, new investors will experience further dilution.

Table of Contents**SELECTED FINANCIAL AND OTHER DATA**

The following selected financial and other data regarding our business should be read in conjunction with, and are qualified by reference to, Management's Discussion and Analysis of Financial Condition and Results of Operations and our Financial Statements and related notes included elsewhere in this prospectus. We derived the statement of operations data for the years ended January 31, 2009, 2010 and 2011, as well as the balance sheet data as of January 31, 2010 and 2011 from our audited financial statements included elsewhere in this prospectus. We derived the statement of operations data for the year ended January 31, 2008, as well as the balance sheet data as of January 31, 2008 and 2009 from our audited financial statements not included in this prospectus. We derived the unaudited statement of operations data for the year ended January 31, 2007 as well as the unaudited balance sheet data as of January 31, 2007 from our unaudited financial statements not included in this prospectus. We derived the unaudited statement of operations data for the three months ended April 30, 2010 and 2011 and the balance sheet data as of April 30, 2011 from our unaudited financial statements included elsewhere in this prospectus. The unaudited interim financial statements data has been prepared on the same basis as the audited financial statements and reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial information set forth in those statements. Our historical results are not necessarily indicative of results to be expected in any future period, and results for the three months ended April 30, 2011 are not necessarily indicative of results to be expected for the full fiscal year.

	2007 (unaudited)	Fiscal Year Ended January 31,				Three Months Ended April 30,	
		2008	2009	2010	2011	2010 (unaudited)	2011 (unaudited)
		(in thousands, except per share data)					
Statement of Operations Data:							
Revenue:							
Advertising	\$ 3,250	\$ 13,314	\$ 18,247	\$ 50,147	\$ 119,333	\$ 18,446	\$ 43,661
Subscription services and other	925	985	1,086	5,042	18,431	3,153	7,379
Total revenue	4,175	14,299	19,333	55,189	137,764	21,599	51,040
Costs and expenses:							
Cost of revenue ⁽¹⁾	3,142	5,850	7,398	7,892	11,559	2,390	4,360
Product development ⁽¹⁾	382	5,932	6,116	6,026	6,736	1,499	2,731
Marketing and sales ⁽¹⁾	562	8,214	13,265	17,426	36,250	5,433	12,964
General and administrative ⁽¹⁾	9,574	2,577	4,190	6,358	14,183	2,471	6,943
Content acquisition	3,240	6,402	15,771	32,946	69,357	12,616	29,158
Total costs and expenses	16,900	28,975	46,740	70,648	138,085	24,409	56,156
Loss from operations	(12,725)	(14,676)	(27,407)	(15,459)	(321)	(2,810)	(5,116)
Other income (expense), net	902	688	(821)	(1,294)	(1,309)	(194)	(1,616)
Loss before provision for income taxes	(11,823)	(13,988)	(28,228)	(16,753)	(1,630)	(3,004)	(6,732)
Provision for income taxes					134		22
Net loss	(11,823)	(13,988)	(28,228)	(16,753)	(1,764)	(3,004)	(6,754)
Deemed dividend on Series D and Series E				(1,443)			
Accretion of redeemable convertible preferred stock	(53)	(58)	(58)	(218)	(300)	(81)	(70)
Increase in cumulative dividends payable upon conversion of liquidation of redeemable convertible preferred stock	(2,949)	(3,705)	(3,751)	(6,461)	(8,978)	(1,883)	(2,320)
Net loss attributable to common stockholders	\$ (14,825)	\$ (17,751)	\$ (32,037)	\$ (24,875)	\$ (11,042)	\$ (4,968)	\$ (9,144)
Basic and diluted net loss per share	\$ (3.62)	\$ (3.80)	\$ (5.45)	\$ (3.84)	\$ (1.03)	\$ (0.64)	\$ (0.61)
Weighted-average number of shares used in per share amounts basic and diluted	4,097	4,671	5,881	6,482	10,761	7,791	14,900

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Pro forma net loss per share basic and diluted (unaudited)	\$ (0.01)	\$ (0.03)
Pro forma weighted average shares used in calculating pro forma net loss per share attributable to common stockholders basic and diluted (unaudited)	147,213	154,050

Table of Contents**Key Metrics (unaudited):⁽²⁾**

	Fiscal Year Ended January 31,			Three Months Ended April 30,	
	2009	2010	2011	2010	2011
Listener hours (in billions) ⁽³⁾	0.9	1.8	3.8	0.7	1.6
Registered users (end of period, in millions) ⁽⁴⁾	22	45	82	53	94
Active users (end of period, in millions) ⁽⁵⁾	7	16	29	18	34

	2007	2008	As of January 31,		2011	As of April 30,
	(unaudited)		2009	2010		2011
			(in thousands)			(unaudited)
Balance Sheet Data:						
Cash and cash equivalents	\$ 25,646	\$ 11,810	\$ 9,608	\$ 16,164	\$ 43,048	\$ 43,718
Working capital (deficit)	24,389	10,409	(3,114)	18,929	36,715	36,218
Total assets	29,706	18,629	16,685	40,277	99,209	101,605
Preferred stock warrant liability	83	99	49	300	1,027	2,550
Convertible preferred stock	49,438	52,638	62,560	104,806	126,662	128,757
Common stock and additional paid-in capital		1	726	1	2,309	1,306
Total stockholders' deficit	(23,431)	(40,247)	(63,510)	(87,771)	(83,010)	(90,767)

(1) Includes stock-based compensation as follows:

	2007	Fiscal Year Ended January 31,			2011	Three Months Ended April 30,	
	(unaudited)	2008	2009	2010		2010	2011
			(in thousands)				(unaudited)
Cost of revenue	\$ 4	\$ 10	\$ 14	\$ 18	\$ 85	\$ 6	\$ 64
Product development	11	44	54	125	329	40	177
Marketing and sales	27	158	188	225	549	76	423
General and administrative	194	71	77	109	492	70	272
Total stock-based compensation	\$ 236	\$ 283	\$ 333	\$ 477	\$ 1,455	\$ 192	\$ 936

(2) Comparative information is not readily available prior to fiscal 2009.

(3) Listener hours are defined as the aggregate amount of time listeners have used our service in a given period.

(4) Registered users are defined as the total number of accounts that have been created for our service at period end. To become a registered user, a person must provide an email address, but the information we collect from listeners does not permit us to identify when a listener may have created multiple accounts, nor prevent listeners from creating multiple accounts. We believe that, while imperfect, our number of registered users is indicative of the growth of awareness of Pandora.

(5) Active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion of our financial condition and results of operations in conjunction with the financial statements and the notes thereto included elsewhere in this prospectus. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this prospectus, particularly in the section titled "Risk Factors." All references herein to a fiscal year refer to the 12 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.

Overview

Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners. 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. In April 2011, we had over 90 million registered users and we added a new registered user every second on average. We have more than a 50% share of internet radio listening time among the top 20 stations and networks in the United States, according to a November 2010 report by Ando. Since we launched the Pandora service in 2005, our listeners have created over 1.4 billion stations.

In 2000, we started the Music Genome Project, and since then we have continuously built our song catalog, refined the genotyping model and developed proprietary algorithms for building personalized playlists for our listeners based both on our analysis and feedback data from our listeners. In July 2005, leveraging our investment in the Music Genome Project, we launched the Pandora service as a free, advertising-supported internet radio service. In May 2007 we introduced the first mobile version of our service primarily for use on cellular phones. By the end of that fiscal year, we had over 10 million registered users.

We launched the Pandora app for smartphones on the iPhone in July 2008, and have subsequently launched on Android and Blackberry phones. Driven in large part by the popularity of the Pandora apps, growth in the overall smartphone market and increased adoption of our traditional computer-based service, by the end of that fiscal year we had over 22 million registered users.

One key element of our strategy is to make the Pandora service available everywhere in the United States that there is internet connectivity. To this end, in 2006 we began to partner with manufacturers of home entertainment systems and other consumer electronics products to integrate the Pandora service with their products. In 2009 we began to develop relationships with major automobile manufacturers and their suppliers to introduce the Pandora service for automobiles, including select models of Ford Motor Company, Mercedes-Benz and MINI (BMW Group) vehicles. Additionally, General Motors, Hyundai and Toyota have publicly announced their plans for future Pandora integrations.

Our comedy service, which we launched in May 2011, leverages similar technology to the technology underlying the Music Genome Project, allowing a listener to choose a favorite comedian or a genre as a seed to start a station and then give feedback to personalize that station. Our comedy collection includes content from more than 700 comedians with more than 10,000 tracks.

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We derive the substantial majority of our revenue from the sale of display, audio and video advertising for delivery across our traditional computer-based, mobile and other connected device platforms. To date, our revenue growth has been principally attributable to selling display advertising through our traditional computer-based platform. The rapid adoption of our service on mobile and other connected devices presents an opportunity for us to reach our audience anytime, anywhere they enjoy music, and therefore to offer additional distribution channels to current and potential advertisers for delivery of their advertising messages.

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The growth in our registered users and distribution platforms has fueled a corresponding growth in listener hours. Our total number of listener hours is a key driver for both revenue generation opportunities and content acquisition expenses, which are the largest component of our operating expenses:

Revenue. Listener hours define the number of opportunities we have to sell advertisements, which we refer to as inventory. Our ability to attract advertisers depends in large part on our ability to offer sufficient inventory within desired demographics. In turn, our ability to generate revenue depends on the extent to which we are able to sell the inventory we have.

Content Acquisition Expenses. Listener hours drive substantially all of our content acquisition expenses. We pay royalties to the copyright owners of both sound recordings and the underlying musical works themselves, and we record these royalties as content acquisition expenses. Under U.S. law, we are guaranteed the right to stream any lawfully released sound recordings, and royalties are negotiated with and paid through performance rights organizations such as SoundExchange for sound recordings and BMI, ASCAP and SESAC for musical works. Royalties are calculated using negotiated rates documented in master royalty agreements and based on revenue earned or other usage measures. If we cannot agree on royalty rates, the dispute will be resolved by the CRB, in the case of SoundExchange, and by the rate court in the case of BMI and ASCAP. In May 2011, we started streaming spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization. For further information about our content licensing arrangements and royalties, please see the section captioned "What We Do" Content, Copyrights & Royalties.

Given the royalty structures in effect with respect to content acquisition, our content acquisition costs increase with each additional listener hour. As such, our ability to achieve operating leverage depends on our ability to increase our revenue per hour of streaming through increased advertising sales.

As our mobile listenership increases, we face new challenges in optimizing our advertising products for delivery on mobile and other connected device platforms. The mobile advertising market is nascent and faces technical challenges due to fragmented platforms and lack of standard audience measurement protocols.

In addition, we expect to increase the number of audio ad campaigns for both traditional computer-based and mobile platforms, placing us in more direct competition with broadcast radio for advertiser spending, and these advertisers predominantly focus on local advertising. By contrast, display advertisers have been predominantly national brands. Our success selling audio ads in large part may require us to convince a substantial base of local advertisers of the benefits of advertising on the Pandora service.

In fiscal 2011, we began to substantially increase our expenditures for product development, marketing and sales and general and administrative expenses to generate growth and provide support infrastructure for that anticipated growth. We expect that this increased level of operating expenses will continue into the future.

Our total revenue has grown from \$19.3 million in fiscal 2009 to \$137.8 million in fiscal 2011 and from \$21.6 million to \$51.0 million for the three months ended April 30, 2010 and 2011, respectively. At the same time, our total costs and expenses have grown from \$46.7 million in fiscal 2009 to \$138.1 million in fiscal 2011 and from \$24.4 million to \$56.1 million for three months ended April 30, 2010 and 2011, respectively, principally as a result of the growth in content acquisition expenses. As the volume of music we stream to listeners increases, our content acquisition expense will also increase, regardless of whether we are able to generate more revenue. In addition, we expect to invest heavily in our operations to support anticipated future growth and public company reporting and compliance obligations, as discussed more fully below. As a result of these factors, we expect to continue to incur operating losses on an annual basis through at least the end of fiscal 2012.

Table of Contents**Key Metrics**

We track listener hours because it is a key indicator of the growth of our business, the number of registered users as a measure of our brand awareness and the number of active users as an additional indicator of the breadth of audience we are reaching at a given time, which is particularly important to potential advertisers. The table below sets forth our listener hours for fiscal 2009, fiscal 2010 and fiscal 2011 and the three months ended April 30, 2010 and 2011, as well as our registered users and active users as of the end of each of those periods.

	Fiscal Year Ended			Three Months Ended	
	January 31,			April 30,	
	2009	2010	2011	2010	2011
Listener hours (in billions)	0.9	1.8	3.8	0.7	1.6
Registered users (end of period, in millions)	22	45	82	53	94
Active users (end of period, in millions)	7	16	29	18	34

Listener hours are defined as the aggregate amount of time listeners have used our service in a given period and as discussed in greater detail in Overview, above.

Registered users are defined as the total number of accounts that have been created for our service at period end. To become a registered user, a person must provide an email account and other demographic information, but the information we collect from listeners does not permit us to identify when a listener may have created multiple accounts, nor prevent listeners from creating multiple accounts. We believe that, while imperfect, our number of registered users is indicative of the growth of awareness of Pandora.

Active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts.

Basis of Presentation**Revenue**

Advertising Revenue. We generate advertising revenue primarily from display, audio and video advertising, which is typically sold on a cost-per-thousand impressions, or CPM, basis. Advertising campaigns typically range from one to 12 months, and advertisers generally pay us based on a minimum number of impressions or the satisfaction of other criteria, such as click-throughs. We may earn referral revenue when, for example, a listener clicks on an advertisement and signs up for membership with an advertiser. We also have arrangements with advertising agencies and brokers pursuant to which we provide the ability to sell advertising inventory on our service directly to advertisers. We report revenue under these arrangements net of amounts due to agencies and brokers.

In fiscal 2011 and the three months ended April 30, 2011, advertising revenue accounted for 86.6% and 85.5% of our total revenue, respectively, and we expect that advertising will comprise a substantial majority of revenue for the foreseeable future. In fiscal 2010 and 2011 and the three

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months ended April 30, 2011, Google accounted for 11.4%, 6.3% and 2.3%, respectively, of our total revenue. Pursuant to our arrangements with Google, Google acts as an online advertising agency, delivering relevant ads on our unsold ad space across both our traditional computer and mobile platforms. Google maintains the direct relationships with the advertisers and ad networks, and we receive a portion of the revenue Google derives from these ads, generally earned on a cost-per-click basis. While these cost-per-click arrangements continue to apply unless terminated by either party, Google can terminate these agreements at will. If these agreements with Google are terminated, we may not be able to enter into agreements with alternative third-party ad providers on acceptable terms, or on a timely basis or both.

Our ability to attract advertisers, and ultimately generate advertising revenue, will be critical to our financial success. We believe that we provide a unique and commercially attractive advertising opportunity for our

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advertisers, including the ability to run multi-platform ad campaigns and to present ads while our listeners actively engage with our service. Although advertisers as a whole are spending an increasing amount of their advertising budget on online advertising, we face a number of challenges. Specifically, we compete for advertising dollars with significantly larger and more established online marketing and media companies, such as Facebook, Google, MSN and Yahoo!. In addition, our audio advertising products target advertisers that traditionally advertise on broadcast radio and are less familiar with internet radio advertising media.

Subscription Services and Other Revenue. We generate subscription revenue through the sale of access to a premium version of the Pandora service for \$36 per year, which currently includes higher quality audio and an ad free environment. We receive the full amount of the subscription payment at the time of sale; however, subscription revenue is recognized on a straight-line basis over the subscription period. In addition, for listeners who are not subscribers, we limit usage of our advertising-supported service on traditional computers to 40 hours per month. Listeners who reach this limit may continue to use this service by paying \$0.99 for the remainder of the month. We include this revenue in subscription revenue. In fiscal 2011 and the three months ended April 30, 2011, subscription services and other revenue accounted for 13.4% and 14.5% of our total revenue, respectively.

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.

Costs and Expenses

Costs and expenses consist of cost of revenue, product development, marketing and sales, general and administrative and content acquisition expenses. Content acquisition expenses are the most significant component of our costs and expenses followed by employee-related costs, which includes stock-based compensation expenses. We expect to continue to hire new employees in order to support our anticipated growth as a public company. In any particular period, the timing of additional hires could materially affect our operating expenses, both in absolute dollars and as a percentage of revenue. We anticipate that our costs and expenses will increase in the future.

Cost of Revenue. Cost of revenue consists of the infrastructure costs related to content streaming, maintaining our internet radio service and creating and serving advertisements through third-party ad servers, including the employee costs associated with supporting these functions. We make payments to third-party ad servers for the period the advertising impressions or click-through actions are delivered or occur, and accordingly, we record this as a cost of revenue in the related period.

Product Development. Product development expenses consist of employee compensation, information technology, consulting, facilities-related expenses and costs associated with supporting consumer connected-device manufacturers in implementing our service in their products. We incur product development expenses primarily for improvements to our website and the Pandora app, development of new advertising products and development and enhancement of our personalized playlist generating system. We expense product development as incurred. We intend to continue making significant investments in developing new products and enhancing the functionality of our existing products.

Marketing and Sales. Marketing and sales expenses include salaries, commissions and benefits related to employees in sales, marketing and advertising departments. In addition, marketing and sales expenses include third-party marketing, branding, advertising and public relations expenses, as well as facility and other supporting overhead costs. We expect marketing and sales expenses to increase as we hire additional personnel to build out our sales force and ad operations team and expand our business development team to establish relationships with manufacturers of an increasing number of connected devices.

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General and Administrative. General and administrative expenses include employee salaries and benefits for finance, accounting, legal, internal information technology and other administrative personnel. In addition, general and administrative expenses include outside legal and accounting services, facility and other supporting overhead costs and merchant and other transaction costs, such as credit card fees. We expect to incur significant additional expenses in future periods as we continue to invest in corporate infrastructure, including adding personnel and systems to our finance and administrative functions. We also expect to incur additional expenses associated with being a public company, including increased legal and accounting costs, investor relations costs and compliance costs in connection with section 404 of the Sarbanes-Oxley Act.

Content Acquisition. Content acquisition expenses principally consist of royalties paid for streaming music or other content to our listeners. Royalties are calculated using negotiated rates documented in master royalty agreements and are based on both percentage of revenue and listener metrics. For example, under some royalty arrangements we pay a fee per track or fee per session, while in other cases we pay royalties based on a percentage of our revenue. In still other cases we pay royalties based on a combination of these metrics. We periodically test our royalty calculation methods to ensure we are accurately reporting and paying royalties. The performance rights organizations have the right to audit our playlist and payment records, and any such audit could result in disputes over whether we have paid the proper royalties. If such a dispute were to occur, we could be required to pay additional royalties and the amounts involved could be material.

In July 2009 we, together with other webcasters, negotiated new royalty rates on performances with SoundExchange for calendar years 2006 to 2015. The agreement reduced rates originally established by the CRB for calendar years 2006 to 2010 and established new rates for calendar years 2011 to 2015. Prior periods reflect these reduced rates where applicable. For further information about our content licensing arrangements and royalties, see the section captioned *What We Do* *Content, Copyrights & Royalties*.

Provision for Income Taxes. Since our inception, we have been subject to income taxes only in the United States. In the event we expand our operations outside the United States, we will become subject to taxation based on the foreign statutory rates and our effective tax rate could fluctuate accordingly.

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted statutory income tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized.

Table of Contents**Results of Operations**

The following tables present our results of operations for the periods indicated and as a percentage of total revenue. The period-to-period comparisons of results are not necessarily indicative of results for future periods.

	Fiscal Year Ended January 31,			Three Months Ended	
	2009	2010	2011	April 30,	2011
	(in thousands)			(unaudited)	
Revenue:					
Advertising	\$ 18,247	\$ 50,147	\$ 119,333	\$ 18,446	\$ 43,661
Subscription services and other	1,086	5,042	18,431	3,153	7,379
Total revenue	19,333	55,189	137,764	21,599	51,040
Costs and expenses:					
Cost of revenue ⁽¹⁾	7,398	7,892	11,559	2,390	4,360
Product development ⁽¹⁾	6,116	6,026	6,736	1,499	2,731
Marketing and sales ⁽¹⁾	13,265	17,426	36,250	5,433	12,964
General and administrative ⁽¹⁾	4,190	6,358	14,183	2,471	6,943
Content acquisition	15,771	32,946	69,357	12,616	29,158
Total costs and expenses	46,740	70,648	138,085	24,409	56,156
Loss from operations	(27,407)	(15,459)	(321)	(2,810)	(5,116)
Other income (expense):					
Interest income	247	62	31	2	2
Interest expense	(1,126)	(898)	(612)	(100)	(109)
Other income (expense), net	58	(458)	(728)	(96)	(1,509)
Loss before provision for income taxes	(28,228)	(16,753)	(1,630)	(3,004)	(6,732)
Provision for income taxes			134		22
Net loss	(28,228)	(16,753)	(1,764)	(3,004)	(6,754)
Deemed dividend on Series D and Series E		(1,443)			
Accretion of redeemable convertible preferred stock	(58)	(218)	(300)	(81)	(70)
Increase in cumulative dividends payable upon conversion of liquidation of redeemable convertible preferred stock	(3,751)	(6,461)	(8,978)	(1,883)	(2,320)
Net loss attributable to common stockholders	\$ (32,037)	\$ (24,875)	\$ (11,042)	\$ (4,968)	\$ (9,144)
Basic and diluted loss per share	\$ (5.45)	\$ (3.84)	\$ (1.03)	\$ (0.64)	\$ (0.61)
Weighted-average number of shares used in per share amounts (in thousands):					
	5,881	6,482	10,761	7,791	14,900

(1) Includes stock-based compensation as follows:

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Cost of revenue	\$ 14	\$ 18	\$ 85	\$ 6	\$ 64
Product development	54	125	329	40	177
Marketing and sales	188	225	549	76	423
General and administrative	77	109	492	70	272
Total stock-based compensation	\$ 333	\$ 477	\$ 1,455	\$ 192	\$ 936

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	Fiscal Year Ended January 31,			Three Months Ended April 30,	
	2009	2010	2011	2010 (unaudited)	2011
Revenue:					
Advertising	94%	91%	87%	85%	86%
Subscription services and other	6	9	13	15	14
Total revenue	100	100	100	100	100
Costs and expenses:					
Cost of revenue ⁽¹⁾	38	14	8	11	9
Product and development ⁽¹⁾	32	11	5	7	5
Marketing and sales ⁽¹⁾	69	32	26	25	25
General and administrative ⁽¹⁾	22	12	10	11	14
Content acquisition	82	60	50	58	57
Total costs and expenses	242	128	100	113	110
Loss from operations	(142)	(28)		(13)	(10)
Other income (expense):					
Interest income	1				
Interest expense	(6)	(2)			
Other income (expense), net		(1)	(1)		(3)
Loss before provision for income taxes	(146)	(30)	(1)	(14)	(13)
Provision for income taxes					
Net loss	(146%)	(30%)	(1%)	(14%)	(13%)

(1) Includes stock-based compensation as follows:

Cost of revenue	0.1%	0.0%	0.1%	0.0%	0.1%
Product development	0.3	0.2	0.2	0.2	0.3
Marketing and sales	1.0	0.4	0.4	0.4	0.8
General and administrative	0.4	0.2	0.4	0.3	0.5

Comparison of the Three Months Ended April 30, 2010 and 2011**Revenue**

	Three Months Ended April 30,		
	2010	2011	\$ Change
	(in thousands)		
Advertising	\$ 18,446	\$ 43,661	\$ 25,215
Subscription services and other	3,153	7,379	4,226
Total revenue	\$ 21,599	\$ 51,040	\$ 29,441

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Advertising revenue increased \$25.2 million due to increases in the number of advertising campaigns enabled by higher listener hours and higher spending on campaigns by our largest advertisers. Subscription revenue increased \$4.2 million due to an increase of 139% in the number of subscribers.

Costs and Expenses

Cost of Revenue

	Three Months Ended April 30,		\$ Change
	2010	2011 (in thousands)	
Cost of revenue	\$ 2,390	\$ 4,360	\$ 1,970

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Cost of revenue increased \$2.0 million due to a \$1.5 million increase in hosting services costs as a result of a 129% increase in listener hours and a \$0.4 million increase primarily due to higher employee-related expenses driven by an 82% increase in headcount.

Product Development

	Three Months Ended April 30,		\$ Change
	2010	2011 (in thousands)	
Product development	\$ 1,499	\$ 2,731	\$ 1,232

Product development expenses increased \$1.2 million primarily due to higher employee-related expenses driven by a 100% increase in headcount.

Marketing and Sales

	Three Months Ended April 30,		\$ Change
	2010	2011 (in thousands)	
Marketing and sales	\$ 5,433	\$ 12,964	\$ 7,531

Marketing and sales expenses increased \$7.5 million primarily due to a \$5.6 million increase in employee-related expenses driven by a 95% increase in headcount and an increase in external sales and marketing expenses of \$0.9 million related to search engine marketing.

General and Administrative

	Three Months Ended April 30,		\$ Change
	2010	2011 (in thousands)	
General and administrative	\$ 2,471	\$ 6,943	\$ 4,472

General and administrative expenses increased \$4.5 million primarily due to a \$2.5 million increase in employee-related expenses driven by a 220% increase in headcount, a \$1.0 million increase in professional services fees and a \$0.4 million increase in IT infrastructure costs.

Content Acquisition

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	Three Months Ended April 30,		\$ Change
	2010	2011 (in thousands)	
Content acquisition	\$ 12,616	\$ 29,158	\$ 16,542

Content acquisition expenses increased \$16.5 million due to increased royalty payments driven by increased listener hours and by higher revenue.

Table of Contents*Other Income (Expense)*

	Three Months Ended		
	April 30,		
	2010	2011	\$ Change
	(in thousands)		
Interest income	\$ 2	\$ 2	\$
Interest expense	(100)	(109)	(9)
Other income (expense)	(96)	(1,509)	(1,413)
Total other expense	\$ (194)	\$ (1,616)	\$ (1,422)

Total other expenses increased \$1.4 million primarily driven by \$1.5 million higher expenses due to the effect of the increase in the fair value of our preferred stock warrants liability.

Provision for Income Taxes

The state income tax provision increased to \$22,000 from \$0 for the same period in fiscal 2010 as a result of gross receipts taxes owed in states where we had newly identified filing obligations.

Comparison of Fiscal 2009, 2010 and 2011*Revenue*

	Fiscal Year Ended January 31,			FY 2009 to FY 2010 \$ Change	FY 2010 to FY 2011 \$ Change
	2009	2010	2011		
	(in thousands)				
Advertising	\$ 18,247	\$ 50,147	\$ 119,333	\$ 31,900	\$ 69,186
Subscription services and other	1,086	5,042	18,431	3,956	13,389
Total revenue	\$ 19,333	\$ 55,189	\$ 137,764	\$ 35,586	\$ 82,575

2010 Compared to 2011. Advertising revenue increased \$69.2 million due to increases in the number of advertising campaigns enabled by higher listener hours and higher spending on campaigns by our largest advertisers. Subscription services and other revenue increased \$13.4 million due to an increase in the number of subscribers.

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2009 Compared to 2010. Advertising revenue increased \$31.9 million due to increases in the number of advertising campaigns enabled by higher listener hours and higher spending on campaigns by our largest advertisers. Subscription services and other revenue increased \$4.0 million due to an increase in the number of subscribers driven by the launch of our Pandora One subscription service in fiscal 2010.

Cost and Expenses

Cost of Revenue

	Fiscal Year Ended January 31,			FY 2009 to	FY 2010 to
	2009	2010	2011	FY 2010	FY 2011
				\$ Change	\$ Change
			(in thousands)		
Cost of revenue	\$ 7,398	\$ 7,892	\$ 11,559	\$ 494	\$ 3,667

2010 Compared to 2011. Cost of revenue increased \$3.7 million due to a \$2.1 million increase in streaming and hosting costs related to an increase in listener hours and the number of campaigns, a \$0.7 million increase driven by higher employee-related costs due to approximately 40% higher headcount, and \$0.6 million higher depreciation expense due to equipment purchases.

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2009 Compared to 2010. Cost of revenue increased \$0.5 million due to an increase in employee-related costs as a result of a 36% increase in headcount, and to an increase in depreciation expenses, partially offset by a decrease in streaming and hosting costs due to more favorable hosting services rates.

Product Development

	Fiscal Year Ended January 31,			FY 2009 to	FY 2010 to
	2009	2010	2011	FY 2010	FY 2011
				\$ Change	\$ Change
			(in thousands)		
Product development	\$ 6,116	\$ 6,026	\$ 6,736	\$ (90)	\$ 710

2010 compared to 2011. Product development expenses increased \$0.7 million as a \$1.0 million increase in employee-related expenses due to approximately 20% higher headcount was partially offset by lower equipment expense in fiscal 2011 as compared to fiscal 2010.

2009 Compared to 2010. Product development expenses were relatively flat as an increase in infrastructure costs were offset by a decrease in employee-related expenses. Headcount remained relatively flat on a period to period basis.

Marketing and Sales

	Fiscal Year Ended January 31,			FY 2009 to	FY 2010 to
	2009	2010	2011	FY 2010	FY 2011
				\$ Change	\$ Change
			(in thousands)		
Marketing and sales	\$ 13,265	\$ 17,426	\$ 36,250	\$ 4,161	\$ 18,824

2010 Compared to 2011. Marketing and sales expenses increased \$18.8 million due to an \$8.6 million increase in employee-related costs, driven by approximately 90% higher headcount and a \$7.3 million increase in commissions driven by higher revenue and headcount. In addition, marketing and sales expenses increased \$2.4 million related to higher customer acquisition and advertising effectiveness survey costs and higher spending for public relations activities.

2009 Compared to 2010. Marketing and sales expenses increased \$4.2 million due to a \$7.1 million increase in employee-related costs, driven by a 102% increase in headcount, partially offset by a \$2.8 million decrease in marketing expenses.

General and Administrative

	Fiscal Year Ended January 31,			FY 2009 to	FY 2010 to
	2009	2010	2011	FY 2010	FY 2011

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			(in thousands)	\$ Change	\$ Change
General and administrative	\$ 4,190	\$ 6,358	\$ 14,183	\$ 2,168	\$ 7,825

2010 Compared to 2011. General and administrative expenses increased \$7.8 million primarily due to a \$5.3 million increase in employee-related costs driven by approximately 195% higher headcount and higher legal, accounting and other consulting costs. In addition, general and administrative expenses were higher by \$1.6 million primarily due to merchant and other transaction costs.

2009 Compared to 2010. General and administrative expenses increased \$2.2 million due to a \$0.9 million increase in merchant and other transaction costs, a \$0.7 million increase in employee-related expenses, driven by a 50% increase in headcount, and a \$0.5 million increase in legal expenses.

Table of Contents*Content Acquisition*

	Fiscal Year Ended January 31,			FY 2009 to	FY 2010 to
	2009	2010	2011	FY 2010	FY 2011
	(in thousands)			\$ Change	\$ Change
Content acquisition	\$ 15,771	\$ 32,946	\$ 69,357	\$ 17,175	\$ 36,411

2010 Compared to 2011. Content acquisition expenses increased \$36.4 million reflecting higher royalty payments driven by a higher volume of listeners hours, higher royalty rates due to scheduled rate increases and higher revenue.

2009 Compared to 2010. Content acquisition expenses increased \$17.2 million reflecting higher royalty payments driven by a higher volume of listener hours, higher royalty rates due to scheduled rate increases and higher revenue.

Other Income (Expense)

	Fiscal Year Ended January 31,			FY 2009 to	FY 2010 to
	2009	2010	2011	FY 2010	FY 2011
	(in thousands)			\$ Change	\$ Change
Interest income	\$ 247	\$ 62	\$ 31	\$ (185)	\$ (31)
Interest expense	(1,126)	(898)	(612)	228	286
Other income (expense)	58	(458)	(728)	(516)	(270)
Total other income (expense)	\$ (821)	\$ (1,294)	\$ (1,309)	\$ (473)	\$ (15)

2010 Compared to 2011. Total other expense remained largely flat as an expense increase of \$0.6 million related to the change in the fair value of our convertible preferred stock warrant liability was offset by \$0.6 million due to lower interest charges on royalty payments in fiscal 2011 compared to fiscal 2010.

2009 Compared to 2010. Total other expense increased \$0.5 million due to a \$0.5 million increase in the fair value of our convertible preferred stock warrant liability.

Provision for Income Taxes

The provision for income tax expense consists of the following:

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	Fiscal Year Ended January 31,		
	2009	2010	2011
	(in thousands)		
Current			
Federal	\$	\$	\$
State and local			134
Total current income tax expense			134
Deferred			
Federal			
State and local			
Total deferred income tax expense (benefit)			
Total income tax expense (benefit)	\$	\$	\$ 134

2010 Compared to 2011. The state income tax provision increased by \$0.1 million as a result of taxable income that was recognized in certain states. The state taxable income was primarily generated as a result of certain states disallowing bonus depreciation and the utilization of net operating loss carryovers.

Table of Contents*Quarterly Results of Operations*

The following tables set forth selected unaudited quarterly statements of operations data for the last nine fiscal quarters, as well as the percentage that each line item represents of total net revenue. The information for each of these quarters has been prepared on the same basis as the audited financial statements included elsewhere in this prospectus and, in the opinion of management, includes all adjustments, consisting solely of normal recurring adjustments, necessary for the fair presentation of the results of operations for these periods. This data should be read in conjunction with the audited financial statements and accompanying notes included elsewhere in this prospectus. These quarterly operating results are not necessarily indicative of our operating results for any future period. Our fiscal year ends on January 31.

	Three Months Ended								
	April 30, 2009	July 31, 2009	Oct 31, 2009	Jan 31, 2010	April 30, 2010	July 31, 2010	Oct 31, 2010	Jan 31, 2011	April 30, 2011
	(in thousands, except per share data)								
Revenue:									
Advertising	\$ 5,360	\$ 9,225	\$ 14,131	\$ 21,431	\$ 18,446	\$ 26,723	\$ 32,683	\$ 41,481	\$ 43,661
Subscription services and other	363	645	1,628	2,406	3,153	4,112	5,006	6,160	7,379
Total revenue	5,723	9,870	15,759	23,837	21,599	30,835	37,689	47,641	51,040
Costs and expenses:									
Cost of revenue ⁽¹⁾	1,820	1,920	2,068	2,084	2,390	2,503	3,084	3,582	4,360
Product development ⁽¹⁾	1,462	1,520	1,455	1,589	1,499	1,562	1,756	1,919	2,731
Marketing and sales ⁽¹⁾	3,220	3,810	4,790	5,606	5,433	6,736	9,715	14,366	12,964
General and administrative ⁽¹⁾	1,384	1,334	1,874	1,766	2,471	2,880	3,853	4,979	6,943
Content acquisition	6,817	7,589	8,116	10,424	12,616	14,670	18,136	23,935	29,158
Total costs and expenses	14,703	16,173	18,303	21,469	24,409	28,351	36,544	48,781	56,156
Income (loss) from operations	(8,980)	(6,303)	(2,544)	2,368	(2,810)	2,484	1,145	(1,140)	(5,116)
Other income (expense):									
Interest income	8	13	18	23	2	15	9	5	2
Interest expense	(705)	(62)	(42)	(89)	(100)	(117)	(116)	(279)	(109)
Other income (expense), net		11	(51)	(418)	(96)	(750)	6	112	(1,509)
Income (loss) before provision for income taxes	(9,677)	(6,341)	(2,619)	1,884	(3,004)	1,632	1,044	(1,302)	(6,732)
Provision for income taxes								134	22
Income (loss)	(9,677)	(6,341)	(2,619)	1,884	(3,004)	1,632	1,044	(1,436)	(6,754)
Deemed dividend on Series D and Series E redeemable convertible preferred stock		(1,443)							
Accretion of redeemable convertible preferred stock issuance costs	(17)	(33)	(84)	(84)	(81)	(75)	(72)	(72)	(70)
Increase in cumulative dividends payable upon conversion of liquidation of redeemable convertible preferred stock	(1,189)	(1,397)	(1,928)	(1,947)	(1,883)	(1,946)	(2,746)	(2,403)	(2,320)
Net loss attributable to common stockholders	\$ (10,883)	\$ (9,214)	\$ (4,631)	\$ (147)	\$ (4,968)	\$ (389)	\$ (1,774)	\$ (3,911)	\$ (9,144)
Basic and diluted loss per share	\$ (1.80)	\$ (1.48)	\$ (0.71)	\$ (0.02)	\$ (0.64)	\$ (0.04)	\$ (0.15)	\$ (0.31)	\$ (0.61)

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Weighted-average number of shares used in per share amounts (in thousands):	6,042	6,241	6,551	7,073	7,791	10,894	11,686	12,626	14,900
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(1) Includes stock-based compensation as follows:

Cost of revenue	\$ 4	\$ 4	\$ 5	\$ 5	\$ 6	\$ 5	\$ 35	\$ 39	\$ 64
Product development	13	20	40	52	40	43	129	117	177
Marketing and sales	33	52	67	73	76	82	184	207	423
General and administrative	19	25	39	26	70	106	170	146	272
Total stock-based compensation	\$ 69	\$ 101	\$ 151	\$ 156	\$ 192	\$ 236	\$ 518	\$ 509	\$ 936

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	Three Months Ended								
	April 30, 2009	July 31, 2009	Oct 31, 2009	Jan 31, 2010	April 30, 2010	July 31, 2010	Oct 31, 2010	Jan 31, 2011	April 30, 2011
Revenue:									
Advertising	94%	93%	90%	90%	85%	87%	87%	87%	86%
Subscription services and other	6	7	10	10	15	13	13	13	14
Total revenue	100	100	100	100	100	100	100	100	100
Costs and expenses:									
Cost of revenue ⁽¹⁾	32	19	13	9	11	8	8	8	9
Product development ⁽¹⁾	26	15	9	7	7	5	5	4	5
Marketing and sales ⁽¹⁾	56	39	30	24	25	22	26	30	25
General and administrative ⁽¹⁾	24	14	12	7	11	9	10	10	14
Content acquisition	119	77	52	44	58	48	48	50	57
Total costs and expenses	257	164	116	90	113	92	97	102	110
Income (loss) from operations	(157)	(64)	(16)	10	(13)	8	3	(2)	(10)
Other income (expense):									
Interest income									
Interest expense	(12)	(1)						(1)	
Other income (expense), net				(2)		(2)			(3)
Income (loss) before provision for income taxes	(169)	(64)	(17)	8	(14)	5	3	(3)	(13)
Provision for income taxes									
Net income (loss)	(169%)	(64%)	(17%)	8%	(14%)	5%	3%	(3%)	(13%)
Key metrics (unaudited):									
Listener hours (in billions) ⁽²⁾	0.4	0.4	0.4	0.6	0.7	0.8	1.0	1.3	1.6
Registered users ⁽³⁾ (end of period, in millions)	26	31	37	45	53	61	70	82	94
Active users (end of period, in millions) ⁽⁴⁾	9	10	13	16	18	21	24	29	34

(1) Includes stock-based compensation as follows:

Cost of revenue	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%
Product development	0.2	0.2	0.3	0.2	0.2	0.1	0.3	0.2	0.3
Marketing and sales	0.6	0.5	0.4	0.3	0.4	0.3	0.5	0.4	0.8
General and administrative	0.3	0.3	0.2	0.1	0.3	0.3	0.5	0.3	0.5

(2) Listener hours are defined in footnote 3 to our Selected Financial and Other Data.

(3) Registered users are defined in footnote 4 to our Selected Financial and Other Data.

(4) Active users are defined in footnote 5 to our Selected Financial and Other Data.

Quarterly Trends

Our operating results fluctuate from quarter to quarter as a result of a variety of factors. Our general and administrative expense increased dramatically starting in the first quarter of fiscal 2011 as we hired a chief financial officer and general counsel and invested in infrastructure required to sustain our growth and prepared to become a public company. While we had net income in the fourth quarter of fiscal 2010 and the

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second and third quarter of fiscal 2011, we expect to incur losses on an annual basis through at least the end of fiscal 2012. We expect our operating results to continue to fluctuate in future quarters.

Our results may reflect the effects of some seasonal trends in listener behavior due to increased internet usage and sales of media-streaming devices during certain vacation and holiday periods. For example, we expect

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to experience increased usage during the fourth quarter of each calendar year due to the holiday season, and in the first quarter of each calendar year due to increased use of media-streaming devices received as gifts during the holiday season. We may also experience higher advertising sales during the fourth quarter of each calendar year due to greater advertiser demand during the holiday season. While we believe these seasonal trends have affected and will continue to affect our quarterly results, our trajectory of rapid growth may have overshadowed these effects to date. We believe that our business may become more seasonal in the future and that such seasonal variations in listener behavior may result in fluctuations in our financial results.

In addition, expenditures by advertisers tend to be cyclical and discretionary in nature, reflecting overall economic conditions, the economic prospects of specific advertisers or industries, budgeting constraints and buying patterns and a variety of other factors, many of which are outside our control. As a result of these and other factors, the results of any prior quarterly or annual periods should not be relied upon as indications of our future operating performance.

Liquidity and Capital Resources

As of April 30, 2011 we had cash and cash equivalents of \$43.7 million, which consisted of money market funds held at major financial institutions. Since inception, we have financed our operations primarily through private sales of equity and, to a lesser extent, from borrowings. Our principal uses of cash are funding our operations, debt service payments, as described below, and capital expenditures.

Sources of Funds

We believe, based on our current operating plan, that our existing cash and cash equivalents and available borrowings under our credit facility will be sufficient to meet our anticipated cash needs for at least the next 12 months.

From time to time, we may explore additional financing sources and means to lower our cost of capital, which could include equity, equity-linked and debt financing. In addition, in connection with any future acquisitions, we may require additional funding which may be provided in the form of additional debt, equity or equity-linked financing or a combination thereof. There can be no assurance that any additional financing will be available to us on acceptable terms.

Our Indebtedness

We have entered into (1) a loan and security agreement, which provides for revolver borrowings, letters of credit, and certain other types of borrowings, which we refer to as our credit facility and (2) an equipment loan and security agreement which is available to finance the acquisition of equipment, which we refer to as the equipment financing line. Any inability to meet our debt service obligations could have material consequences to our security holders.

Credit Facility. On May 13, 2011, we entered into a \$30 million credit facility with a syndicate of financial institutions. Affiliates of J.P. Morgan Securities LLC and Morgan Stanley & Co. LLC are lenders under the credit facility, an affiliate of Morgan Stanley & Co. LLC is the

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documentation agent and an affiliate of J.P. Morgan Securities LLC is the administrative agent for the credit facility. The amount of borrowings available under the credit facility at any time is based on our monthly accounts receivable balance at such time, and the amounts borrowed are collateralized by our personal property (including such accounts receivable but excluding intellectual property). At our option, drawn amounts under the credit facility will bear an interest rate of either (i) an adjusted London Interbank offered, or LIBO, rate plus (A) 3.00% (if the debt outstanding is greater than or equal to \$15 million) or (B) 2.75% (if the debt outstanding is less than \$15 million) or (ii) an alternate base rate plus (x) 2.00% (if the debt outstanding is greater than or equal to \$15 million) or (y) 1.75% (if the debt outstanding is less than \$15 million). The adjusted LIBO rate is the LIBO rate for a particular interest period multiplied by the statutory reserve

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rate. The alternate base rate is the greatest of the prime rate, the federal funds effect rate plus 0.5% and the adjusted LIBO rate plus 1%. In addition, we are obligated to pay a non-usage charge on the unborrowed balance. The non-usage charge is 0.5% (if the debt outstanding is greater than or equal to \$15 million) or 0.625% (if the debt outstanding is less than \$15 million). As of May 13, 2011, we had \$9 million drawn and \$21 million of available borrowing capacity under the credit facility. As of May 13, 2011, the interest rate on the drawn amount is 2.95%. The credit facility contains customary events of default, conditions to borrowing and covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur debt, incur liens and make distribution to stockholders. The credit facility also includes a financial covenant requiring the maintenance of minimum liquidity of at least \$5 million. During the continuance of an event of a default, the lenders may accelerate amounts outstanding, terminate the credit facility and foreclose on all collateral.

Prior Credit Facility. In September 2009, we entered into a credit facility pursuant to which we may incur indebtedness up to the lesser of \$10.0 million and a borrowing base equal to 80% of eligible accounts. Advances under the credit facility bear interest on the outstanding daily balance, at an annual rate equal to the lender's prime rate plus 0.5%. We have pledged all of our personal and intellectual property to the lender, other than equipment purchased with proceeds of the equipment financing line, to secure our obligations under the credit facility. The credit facility contains customary events of default, conditions to borrowings and restrictive covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur debt, incur liens, make distributions to our stockholders, make investments or enter into certain types of related party transactions. The credit facility also includes financial covenants including covenants to maintain a specified asset coverage ratio of 1.75 to 1.00 or a cash and cash equivalents balance of at least \$10.0 million. As of January 31, 2009, we were in violation of a requirement to cure payment defaults to SoundExchange no later than January 31, 2009. The lender waived the compliance with such covenant until July 31, 2009 and we regained compliance before such date. As of July 31, 2010, we were in violation of a requirement to provide audited financial statements to the lender within 180 days of our fiscal year-end. The lender waived such requirement until February 15, 2011 and we regained compliance with such covenant by delivering the financial statements on February 11, 2011. As of January 31, 2011 and April 30, 2011, we had \$6.0 million of revolver borrowings outstanding, available credit of \$4.0 million and the interest rate was 4.5%. On May 13, 2011 this credit facility was paid in full and terminated.

Equipment Financing Line. In September 2009, we entered into the equipment financing line pursuant to which we may incur up to \$2.0 million in indebtedness to purchase equipment. Advances under the equipment financing line bear interest at per year rate equal to 9.0%. For the first six months after each advance, we are required to pay interest only and after such six-month interest-only period, we are required to make 30 equal monthly payments of interest and principal. We have pledged all of the equipment purchased with proceeds of the equipment financing line to secure our obligations under the equipment financing line. The equipment financing line contains customary events of default, conditions to borrowings and covenants. As of July 31, 2010, we were in violation of a requirement to provide audited financial statements to the lender within 180 days of our fiscal year-end. The lender waived such requirement until March 31, 2011 and we regained compliance with all covenants by delivering the financial statements on February 11, 2011. On May 13, 2011 this equipment financing line was paid in full and terminated.

Uses of Funds

Dividend Payments. We will use a portion of the net proceeds of this offering to pay accrued and unpaid dividends on our redeemable convertible preferred stock in connection with the automatic conversion of such redeemable convertible preferred stock into common stock upon the closing of this offering. The amount of such accrued dividends will be equal to approximately (1) \$29.7 million, which is the amount of accrued dividends if the closing had occurred on April 30, 2011, plus approximately (2) \$26,000 per day for the period from April 30, 2011 to the date of the closing.

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Capital Expenditures. Consistent with previous periods, future capital expenditures will focus on acquiring additional hosting and general corporate infrastructure. Based on current estimates, we believe that the amount of capital expenditures permitted to be made under the credit agreement will be adequate to implement our current plans.

Historical Trends

The following table summarizes our cash flow data for fiscal 2009, 2010 and 2011 and for the three months ended April 30, 2010 and 2011.

	Fiscal Year Ended January 31,			Three Months Ended	
	2009	2010	2011	April 30,	2011
	(in thousands)			(unaudited)	
Net cash provided by (used in) operating activities	\$ (14,703)	\$ (27,474)	\$ 3,222	\$ 5,023	\$ 2,784
Net cash provided by (used in) investing activities	6,967	(1,569)	(7,893)	(337)	(2,086)
Net cash provided by (used in) financing activities	13,762	35,599	31,555	3,701	(19)

Operating Activities

In the three months ended April 30, 2011, net cash provided by operating activities was \$2.8 million including our net loss of \$6.8 million and non-cash charges of \$3.2 million. In addition, cash inflows from changes in operating assets and liabilities included an increase in accrued royalties of \$3.0 million due to the timing of royalty payments and an increase in the number of listeners, an increase in accrued compensation of \$2.8 million related to higher employee bonus compensation due to higher revenue, and an increase in deferred revenue of \$1.5 million primarily related to an increase in customers purchasing subscriptions for Pandora One, partially offset by cash outflows of \$1.4 million in prepaid expenses and other assets primarily related to deferred costs associated with this offering.

In the three months ended April 30, 2010, net cash provided by operating activities was \$5.0 million, including our net loss of \$3.0 million and non-cash charges of \$0.5 million. In addition, cash inflows from changes in operating assets and liabilities included lower accounts receivable of \$2.7 million related to the timing of payments, an increase in deferred revenue of \$1.8 million primarily related to an increase in customers purchasing subscriptions for Pandora One and an increase in accrued royalties of \$2.0 million due to the timing of royalty payments and an increase in the number of listeners.

In fiscal 2011, net cash provided by operating activities was \$3.2 million, including our net loss of \$1.8 million and non-cash charges of \$4.1 million. In addition, cash outflows from changes in operating assets and liabilities included an increase in accounts receivable of \$23.0 million related to higher advertising sales. Cash inflows from changes in operating assets and liabilities included an increase in deferred revenue of \$9.8 million primarily related to an increase in customers purchasing subscriptions for Pandora One and an increase in accrued royalties of \$9.0 million due to the timing of royalty payments and increase in the number of listeners.

In fiscal 2010, we used \$27.5 million in operating activities, including our net loss of \$16.8 million, partially offset by non-cash charges of \$2.1 million. In addition, cash outflows from changes in operating assets and liabilities included an increase in accounts receivable of \$14.9 million related to higher advertising sales and a decrease in accrued royalties of \$2.2 million due to the timing of royalty payments. Cash inflows from changes in operating assets and liabilities included an increase in deferred revenue of \$5.6 million primarily related to an increase in customers

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purchasing subscriptions to our Pandora One service.

In fiscal 2009, we used \$14.7 million in operating activities, including our net loss of \$28.2 million, partially offset by non-cash charges of \$1.4 million. In addition, cash outflows from changes in operating assets and liabilities consisted primarily of an increase in accounts receivable of \$0.6 million. Cash inflows from changes in

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operating assets and liabilities included an increase in accrued royalties of \$11.0 million due to the timing of royalty payments and an increase in accounts payable of \$0.8 million due to the timing of payments.

Investing Activities

Cash used in investing activities in the three months ended April 30, 2011 was \$2.1 million consisting primarily of capital expenditures for server equipment.

Cash used in investing activities in the three months ended April 30, 2010 was \$0.3 million consisting primarily of capital expenditures for server equipment.

Cash used in investing activities in fiscal 2011 was \$7.9 million consisting primarily of capital expenditures of \$8.3 million, primarily for server equipment, partially offset by lower restricted cash requirements.

Cash used in investing activities in fiscal 2010 was \$1.6 million consisting primarily of capital expenditures of \$1.9 million, primarily for server equipment, partially offset by lower restricted cash requirements.

Cash provided by investing activities in fiscal 2009 was \$7.0 million consisting primarily of the sale and maturities of marketable securities of \$8.2 million, partially offset by the purchase of equipment and software of \$0.6 million, and an increase in restricted cash of \$0.6 million due to higher collateral requirements against a higher outstanding balance on our line of credit.

Financing Activities

Cash used in financing activities in the three months ended April 30, 2011 was \$19,000 consisting of repayment of debt of \$0.2 million partially offset by proceeds from issuance of common stock of \$0.1 million.

Cash provided by financing activities in the three months ended April 30, 2010 was \$3.7 million consisting primarily of net proceeds from borrowings of \$3.4 million.

Cash provided by financing activities in fiscal 2011 was \$31.6 million consisting primarily of net proceeds of \$22.2 million from the issuance of 8.1 million shares of Series G redeemable convertible preferred stock and proceeds from the issuance of both vested and unvested common stock of \$6.1 million.

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Cash provided by financing activities in fiscal 2010 was \$35.6 million consisting primarily of net proceeds of \$34.1 million from the issuance of 45.8 million shares of Series F redeemable convertible preferred stock and net borrowings of \$1.4 million.

Cash provided by financing activities in fiscal 2009 was \$13.8 million consisting primarily of net proceeds of \$14.5 million from the issuance of 8.6 million shares of Series E redeemable convertible preferred stock.

Contractual Obligations and Commitments

The following summarizes our contractual obligations as of April 30, 2011:

	Total	Payments Due by Period			More Than 5 Year
		Less Than 1 Year	1-3 Years (in thousands)	4-5 Years	
Operating lease obligations	\$ 14,288	\$ 1,940	\$ 4,421	\$ 4,540	\$ 3,387
Term loan	7,433			7,433	
Redeemable convertible preferred stock and dividends	188,771			188,771	
Total	\$ 210,492	\$ 1,940	\$ 4,421	\$ 200,744	\$ 3,387

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Off-Balance Sheet Arrangements

As of January 31, 2009, 2010 and 2011 and April 30, 2011, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

We believe that the assumptions and estimates associated with our revenue recognition, allowance for doubtful accounts, stock based compensation, stock option grants and common stock valuations, and accounting for income taxes have the greatest potential impact on our financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

Revenue Recognition

We recognize revenue when four basic criteria are met: (1) persuasive evidence exists of an arrangement with the customer reflecting the terms and conditions under which the products or services will be provided; (2) delivery has occurred or services have been provided; (3) the fee is fixed or determinable; and (4) collection is reasonably assured. We consider a signed agreement, a binding insertion order or other similar documentation to be persuasive evidence of an arrangement. Collectability is assessed based on a number of factors, including transaction history and the creditworthiness of a customer. If it is determined that collection is not reasonably assured, revenue is not recognized until collection becomes reasonably assured, which is generally upon receipt of cash. We record cash received in advance of revenue recognition as deferred revenue.

Advertising Revenue

We generate the majority of our revenue through the delivery of advertising impressions sold on a cost per thousand, or CPM, basis. We generally recognize revenue based on delivery information from our campaign trafficking systems. We generate a small amount of referral revenue from performance-based arrangements, which may include the listener performing some action such as clicking on an advertisement and signing up for a membership with that advertiser. We record revenue from these performance-based actions when we receive third-party verification reports supporting the number of actions performed in the period. We generally have audit rights to the underlying data summarized in these reports.

Subscription Services and Other Revenue

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Subscription revenue is generated through the sale of a premium version of the Pandora service which currently includes higher audio quality and advertisement-free access. Subscription revenue is recognized on a straight-line basis over the length of the subscription period.

Other revenue is generated when a listener who does not have a subscription and has listened to a maximum number of free hours of music pays a nominal fee to listen to an unlimited amount of music for the rest of the month. Such revenue is recognized in the month when service is delivered.

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Revenue Recognition for Multiple-Element Arrangements

We enter into arrangements with customers to sell advertising packages that include different media placements or ad services that are delivered at the same time, or within close proximity of one another. Because we had not yet established the fair value for each element and our agreements contain mid-campaign cancellation clauses, advertising sales revenue prior to February 1, 2011 was recognized as the lowest of (1) revenue calculated on a time-based straight-line basis over the term of the contract, (2) revenue calculated on a proportional performance basis, based on CPM for the entire campaign multiplied by the number of impressions delivered to date and (3) revenue based on the delivered media and price as specified on the applicable insertion order. Significant creative or engineering professional services provided adjunct to a campaign are not considered to have standalone value. As a result, we recognized revenue for all elements of multiple-element arrangements as a single unit of accounting over the delivery period.

Beginning on February 1, 2011, we adopted new authoritative guidance on multiple element arrangements using the prospective method for all arrangements entered into or materially modified from the date of adoption. Under this new guidance we allocate arrangement consideration in multiple-deliverable revenue arrangements at the inception of an arrangement to all deliverables or those packages in which all components of the package are delivered at the same time, based on the relative selling price method in accordance with the selling price hierarchy, which includes: (1) vendor-specific objective evidence, or VSOE, if available; (2) third-party evidence, or TPE, if VSOE is not available; and (3) best estimate of selling price, or BEBP, if neither VSOE nor TPE is available. BEBP is generally used to allocate the selling price to deliverables in our multiple element arrangements. We determine BEBP for deliverables by considering multiple factors including, but not limited to, prices we charge for similar offerings, sales volume, market conditions, competitive landscape and pricing practices. We recognize the relative fair value of the media placements or ad services as they are delivered assuming all other revenue recognition criteria are met. As a result of implementing this recent authoritative guidance, we recognized \$1.6 million as revenue in the three months ended April 30, 2011 that would have been deferred under the previous guidance for multiple element arrangements.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts receivable balances. The allowance is based upon historical loss patterns, the number of days billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts.

Stock-Based Compensation

We measure stock-based compensation expenses for employees at the grant date fair value of the award, and recognize expenses on a straight-line basis over the requisite service period, which is generally the vesting period. We account for stock options issued to non-employees in accordance with the guidance for equity-based payments to non-employees. We believe that the fair value of stock options is more reliably measured than the fair value of the services received. As such, the fair value of the unvested portion of the options granted to non-employees is re-measured each period. The resulting increase in value, if any, is recognized as expense during the period the related services are rendered.

We estimate the fair value of stock-based payment awards using the Black-Scholes option-pricing model. The determination of the fair value of a stock-based award on the date of grant using the Black-Scholes option-pricing model is affected by our stock price on the date of grant as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the award, actual and projected employee stock option exercise behaviors, the risk-free interest rate for the expected term of the award and expected dividends. The value of the portion of the award that is ultimately expected to vest is recognized as expense in our statements of operations.

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The following table summarizes the assumptions relating to our stock options granted in fiscal 2011:

Dividend yield	0%
Volatility	57-58%
Risk free interest rate	1.41-2.92%
Expected term, in years	5.91-6.09

We use an expected dividend rate of zero based on the fact that we currently have no history or, except as set forth in *Liquidity and Capital Resources Use of Funds*, expectation of paying cash dividends on our capital stock. Because our common stock has never been publicly traded, we estimate the expected volatility of our awards from the historical volatility of selected public companies within the internet and media industry with comparable characteristics to us, including similarity in size, lines of business, market capitalization, revenue and financial leverage. The risk free interest rate is based on the implied yield currently available on U.S. Treasury issues with terms approximately equal to the expected life of the option. In addition, we assume a forfeiture rate that is based on the historical average period of time that options were outstanding and adjusted for expected changes in future exercise patterns.

Stock Option Grants and Common Stock Valuations

We granted stock options with the following exercise prices since February 1, 2010:

Grant Date	Shares underlying options	Exercise Price
April 21-22, 2010	3,258,500	\$ 0.71
June 2, 2010	252,000	0.94
August 16, 2010	1,735,500	3.14
October 20, 2010	1,185,000	3.14
December 8, 2010	461,500	3.14
January 26-27, 2011	1,737,000	3.14
February 8, 2011	1,098,000	3.14
March 31, 2011	2,613,000	6.35
April 14, 2011	400,000	6.35
April 18, 2011	548,200	6.35
April 22, 2011	500,000	6.35

Additionally, on January 26, 2011 we sold an aggregate of 1,210,191 shares of common stock to two members of our board of directors for a price of \$3.14 per share in connection with their appointment to the board.

Our board of directors determined that the exercise price per share was equal to at least the fair value of our common stock at each grant date. In the absence of a public trading market, our board of directors considered numerous objective and subjective factors to determine its best estimate of the fair value of our common stock as of the date of each option grant, including, but not limited to, the following factors:

valuations of our common stock performed as of February 28, 2010, May 20, 2010, October 31, 2010 and February 28, 2011;

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recent issuances of preferred stock, as well as the rights, preferences and privileges of our outstanding preferred stock;

the lack of marketability of our common stock;

secondary transactions in our common and preferred stock;

our performance and stage of development;

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the likelihood of achieving a liquidity event for the shares of common stock underlying these stock options, such as an IPO or sale of our company, given prevailing market conditions;

the market performance of comparable companies; and

U.S. capital market conditions.

For the valuation of our common stock, we estimated the fair value of a minority interest in our common equity. We considered two possible scenarios as of each valuation date:

An IPO scenario, where we (1) estimated the future value of total stockholders' equity using a multiple of forecasted revenues as of the estimated IPO date, (2) allocated that equity value to the preferred and common stock on a pro-rata basis considering the preferred stock conversion at an IPO and (3) then discounted the resulting per share common stock value back to the valuation date. The key inputs under this model are the estimated IPO value range, the probability weighting that we assign to each point within the range and the discount rate. We estimated our IPO value range considering a variety of factors, the most significant of which were revenue multiples derived from market data and our forecasted trailing 12-month revenues as of the estimated IPO date. We generally assign a higher probability to the middle of the range and lower probabilities to the low and high end of the range. We determined the discount rate using venture capital rates of return appropriate for our stage of development as of each valuation date.

An option-pricing scenario, where we estimated the present value of total stockholders' equity using a discounted cash flow analysis. Under this method, our projected after tax cash flows available to return to holders of total invested capital were discounted back to the valuation date. The resulting equity value was allocated to the preferred and common stock using the option-pricing method. The option-pricing method treats preferred stock and common stock as call options on our enterprise value to estimate the fair value of our common stock. The value of the call options are determined using the Black-Scholes option-pricing model. The key inputs under this model are our projections of cash flows over the period for which forecasts were available as of each valuation date, which ranged from three to five years, our determination of the terminal value, representing the present value of our future cash flows beyond the three to five year period covered by our forecasts, and the discount rate. We determined the discount rate using venture capital rates of return appropriate for our stage of development as of each valuation date.

We chose these two methods based on the following considerations:

The IPO scenario represents a successful near term exit at a relatively high price. In this scenario, the preferred shares convert to common shares and all shares have the same value.

The option-pricing scenario represents a delayed exit in which the future value may be either higher or lower than the current enterprise value. In this scenario the preferred shares may benefit from downside protection in less successful exits.

Each valuation assigned a probability weighting to the value determined under the IPO scenario and option-pricing scenario based on management's discussions with our board of directors and our assessment of market conditions. This probability weighting was determined based on our plans for an IPO and the uncertainty of our ability to successfully complete an IPO given changes in market conditions for IPOs and our ability to continue to execute against our business plan.

[April 2010 grant](#)

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On April 21 and 22, 2010 our board of directors determined that the fair value of our common stock was \$0.71 per share. As part of this determination, the board considered a third party valuation analysis that concluded that the fair value of our common stock was \$0.71 per share as of February 28, 2010. We concluded

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that it was appropriate to rely on the valuation analysis, which was completed on April 9, 2010 but dated as of February 28, 2010, for purposes of the April 21 and 22, 2010 option grants because there were no significant changes to the business, including our forecasted financial results, and no significant changes to market conditions between February 28, 2010 and the date of the grants.

The key assumptions in the IPO scenario included an estimated IPO value range of \$200 million to \$700 million, assigning probabilities of 20%, 70% and 10% to \$200 million, \$500 million and \$700 million, respectively, and a discount rate of 40%, resulting in an estimated common stock value of \$1.67 per share.

In the option-pricing scenario, the valuation analysis estimated the present value of total stockholders' equity as \$156 million based on the discounted projected cash flows over a three-year period plus a terminal value using a discount rate of 40%, resulting in an estimated common stock value of \$0.38 per share.

The valuation analysis as of February 28, 2010, weighted the IPO scenario at 25% and option-pricing scenario at 75% and arrived at the \$0.71 valuation indicated above. The weighting assigned to the option-pricing scenario is higher than the weighting assigned to the IPO scenario because we had not, at that point in time, undertaken any substantial preparation to become a public company.

June 2010 grant

In May 2010, we issued a total of 8,129,338 shares of our Series G redeemable convertible preferred stock for \$2.737 per share to a group of new and existing investors for an aggregate of approximately \$22.2 million. Because the lead investor in this transaction was unaffiliated with our company prior to this investment, the board of directors determined that this financing constituted an arm's-length transaction.

On June 2, 2010, the board of directors determined that the fair value of our common stock was \$0.94 per share. In addition to considering the Series G redeemable convertible preferred stock financing described above, the board of directors also considered a third party valuation analysis that concluded that the fair value of our common stock was \$0.94 per share as of May 20, 2010.

The key assumptions in the IPO scenario included an estimated IPO value range of \$300 million to \$700 million, assigning probabilities of 10%, 70% and 20% to \$300 million, \$500 million and \$700 million, respectively and a discount rate of 35%, resulting in an estimated common stock value of \$2.11 per share.

In the option-pricing scenario the valuation analysis estimated the present value of total stockholders' equity as \$208 million based on the discounted projected cash flows over a three-year period plus a terminal value, using a discount rate of 35%, resulting in an estimated common stock value of \$0.54 per share.

The valuation analysis weighted the IPO scenario at 25% and option-pricing scenario at 75% and arrived at the \$0.94 valuation indicated above. The weighting assigned to the option-pricing scenario is higher than the weighting assigned to the IPO scenario because we were not ready at that point in time to be a public company and would not be ready for a substantial period of time. In addition we reconciled the estimated equity

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value in the IPO scenario and the option-pricing scenario to the Series G transaction price noting that the implied fair value of the Series G redeemable convertible preferred stock from the analysis equaled the \$2.737 Series G transaction price.

August and October 2010 grants

In July 2010, we received an offer from an unaffiliated party, which we refer to as Party A, proposing to purchase shares of our common stock and preferred stock from our stockholders at a price of \$3.138 per share. Party A had very recently conducted a due diligence review of us but had not invested in our stock, and we had subsequently provided Party A with updated historical financial information and access to management in

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connection with the formulation of its offer. We did not pursue this transaction. The board of directors gave careful consideration to the prospect of adding a new significant stockholder to our existing stockholder base, the potential requirement to negotiate new governance and other rights with such stockholder and the demands such a transaction could place on management's time and resources. The board of directors also considered the fact that there was sufficient demand from current investors to purchase shares of our common stock from employees. In light of these factors, the board of directors determined that the third-party offer was not in the best interests of our company and our stockholders.

In August 2010 a group of existing investors that hold rights of first refusal over secondary transactions in our stock commenced an offer to purchase shares of our common stock from our current employees, including our chief executive officer and certain other members of senior management, at \$3.138 per share. Employees tendered an aggregate of 2,520,221 shares of common stock into the offer, which closed in October 2010. Because the price used in this transaction was originally proposed by Party A, a well-informed, sophisticated, knowledgeable, unaffiliated third party, and the participants in this transaction included highly knowledgeable, informed and sophisticated parties as both buyers and sellers, our board of directors determined that the terms of this transaction approximated those that would be obtained in an arms-length transaction.

Based on the foregoing series of transactions over this period, our board of directors determined that there was objective data based on an arms-length, third party offer, that the fair value of the common stock was \$3.14 per share for the option grants made in August 2010. Furthermore, our board of directors determined that the fair value of the common stock was \$3.14 per share for the option grants made in October 2010 because there were no significant changes to the business, including the Company's projected financial results, and no significant changes to market conditions between the August 2010 and the October 2010 grants.

December 8, 2010

In anticipation of granting options during the fourth quarter of the year ending January 31, 2011, we initiated a third party valuation of common stock as of October 31, 2010. The valuation analysis estimated that the fair value of our common stock was \$3.14 per share. This valuation analysis considered several factors including the purchase and sale of approximately 2.5 million shares of our common stock at a price of \$3.138 per share by knowledgeable parties earlier in October 2010. In addition, consistent with the prior analysis, the analysis included an evaluation based on the IPO scenario and the option-pricing scenario. We continued to consider these two methods to reflect the probability of a near term successful exit and the possibility that the exit would be delayed.

The key assumptions in the IPO scenario included an expected valuation range of \$500 million to \$1 billion, with assigned probabilities of 15%, 50% and 35% to \$500 million, \$750 million and \$1 billion, respectively. The estimated IPO value range was primarily determined based on our estimate of the revenue multiple we expected to achieve during our IPO based on our forecasted trailing 12-month revenues as of the estimated IPO date. Our estimated IPO value range yielded multiples of approximately 2.9 to 5.7 of forecasted trailing 12-month revenues as of the estimated IPO date. The resulting probability-weighted multiple of 4.6 was comparable to various market indices for high-tech, internet and entertainment companies and the mean multiples of comparable entities which ranged from approximately 2.0 to 3.5. We then discounted the resulting value using a discount rate of 30%, yielding an IPO scenario estimate of \$3.61 per share.

The option-pricing scenario yielded estimated equity value of \$459 million based on discounted estimated cash flows over a five year period plus a terminal value, resulting in an estimated common stock value of \$1.69 per share. As our business matured, we extended the period over which we produced cash flow forecasts from three to five years.

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The valuation analysis weighted the IPO scenario at 75% and option-pricing scenario at 25% and arrived at the \$3.14 valuation indicated above. The weighting for the IPO scenario increased from 25% used in the May 20, 2010 valuation analysis as a result of discussions with our board of directors and investors and our performance

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relative to our business plan, as well as progress we had made in building our financial and legal infrastructure in preparation for the possibility of becoming a public company.

For the stock options granted on December 8, 2010 the board of directors determined that the fair value of our common stock remained at \$3.14 per share. In arriving at this determination, the board of directors considered several factors, including the following:

Business performance had been in line with projections embedded in the valuation models and the absence of significant changes in market conditions, including revenue multiples in our sector, from October 2010 through the first part of December 2010. As a result, the projected revenue used to support the IPO scenario and the projected cash flows used to support the option-pricing method scenario had not changed and the board determined the valuation performed in October 2010 continued to reflect a reasonable estimate of the fair value of our common stock.

The absence of changes to our estimate of the probability of a successful completion of an IPO from October 31, 2010 to December 8, 2010.

January 26 and 27, 2011 grants and sales

For grants and sales in January 2011, the board of directors determined that the fair value of our common stock remained at \$3.14 per share. In arriving at this determination, the board of directors considered several factors, including the following:

Our estimated revenue for the three months ended January 31, 2011 did not materially impact our forecasted trailing 12-month revenues as of the estimated IPO date. The estimated market capitalization of the Company based on the IPO scenario of \$500 million to \$1 billion with assigned probabilities of 15%, 50% and 35% to \$500 million, \$750 million and \$1 billion, respectively implied a revenue multiple of approximately 4.6. We considered this a reasonable multiple compared to the high-tech, internet and entertainment indices which reflected revenue multiples of approximately 3.0 to 3.5 in January 2011.

Our board of directors determined that the probability of the completion of a successful IPO had not changed from October 31, 2010. In mid-December 2010, we issued requests for proposals to potential underwriters for this offering, requesting proposal submissions by mid-January 2011 and initial meetings at that time. We received proposals, met with investment banks and selected our underwriters in mid-January 2011 based on their reputations, experience with underwriting offerings of companies similar to ours, knowledge of and expertise regarding the digital media industry, understanding of our business model and individual perspectives on how to present the Pandora business to the investment community. Although we had selected the underwriters of our offering in mid-January, the board of directors considered that none of the banks interviewed had offered any indications of value, and that there remained substantial uncertainty over our ability to complete an offering in light of market conditions and the risks associated with our ability to perform in line with our business plan. In late January 2011, we held our organizational meeting with these underwriters. The initial meetings with our underwriters focused on providing an overview of our business, discussing the offering process and drafting disclosure.

We considered whether the initial meetings with underwriters indicated that the weighting of the IPO scenario compared with the option-pricing scenario should be updated. The weighting of the IPO scenario involved management judgment. We believe that the 75% weighting continued to be appropriate as of January 26, 2011. However, if the valuation analysis had been updated as of January 26, 2011 to reflect an increased likelihood of a successful IPO and we changed the weighting of the IPO scenario from 75% to 80%, the fair value of our common stock would have increased from \$3.14 per share to \$3.46 per share as of January 2011. Such an increase in fair value would have resulted in increased compensation expense and other expense for the year ended January 31, 2011 of approximately \$400,000 and \$100,000, respectively.

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February 8, 2011 grant

For the stock options granted on February 8, 2011, the board of directors determined that the fair value of our common stock remained at \$3.14 per share. In arriving at this determination, the board of directors considered the factors described above in connection with the January 26 and 27, 2011 grants and concluded that facts and circumstances had not changed significantly enough to warrant an updated common stock valuation. We concluded that the 75% weighting to the IPO scenario and the 25% weighting to the option-pricing scenario remained appropriate as of February 8, 2011 due to the remaining uncertainty regarding market risks and execution risk that could impact our ability to successfully complete an IPO. However, if the valuation analysis had been updated as of February 8, 2011 to reflect an increased likelihood of a successful IPO and we changed the weighting of the IPO scenario from 75% to 80%, the fair value of our common stock would have increased from \$3.14 per share to \$3.46 per share as of January 2011. Such an increase in fair value would have resulted in an immaterial impact on compensation expense and other expense for the three months ended April 30, 2011.

March 31, 2011 and April 14-22, 2011 grants

In late February 2011, the following three factors led the board of directors to conclude that there were material changes in facts and circumstances that affected our estimate of the fair value of our common stock:

On February 11, 2011, we filed our registration statement of which this prospectus forms a part, which, in the opinion of the board of directors and management, increased the likelihood of completing this offering in June 2011.

In late February 2011, peer companies achieved significant increases in their valuations, including comparable public entities such as Demand Media and Youku, as well as comparable private entities, including Facebook, Groupon, Guardian Unlimited and Zynga, based on news media reports of third-party investments in these companies. We gave specific consideration to Demand Media and Youku given that these particular companies are similarly situated in comparable industries, and had both recently completed their IPOs, with valuations that sustained high multiples several weeks after their IPOs.

In early March 2011, we determined that we exceeded our revenue targets for the month of February 2011 and, consequently, based on the nature of the revenues driving the over-performance, we expected this upward trend to increase our forecasted trailing 12-month revenues as of the estimated IPO date.

As a result of these material changes in facts and circumstances, we obtained a third party valuation of our common stock as of February 28, 2011. The key assumptions in the IPO scenario included an expected valuation range of \$750 million to \$2 billion, assigning probabilities of 10%, 75% and 15% to \$750 million, \$1.5 billion and \$2 billion, respectively, and a discount rate of 28%. The expected valuation range was primarily determined based on our forecasted trailing 12-month revenues as of the estimated IPO date. Our expected IPO valuation yielded a range of multiples of approximately 3.8 to 10.3 of forecasted trailing 12-month revenues as of the estimated IPO date. Though the resulting probability weighted revenue multiple of 7.7 was higher than the market indices for high-tech, internet and entertainment companies and the mean multiples of the comparable entities mentioned above, which ranged from approximately 2.7 to 3.5 at this time, this multiple compared favorably to Demand Media's then current revenue multiple of approximately 7.0. The IPO scenario resulted in a value of \$7.46 per share.

The option-pricing scenario yielded an estimated equity value of \$464 million based on discounted estimated cash flows over a five year period plus a terminal value, using a discount rate of 28%, resulting in a common stock value of \$1.87 per share.

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The valuation analysis weighted the IPO scenario 80% and option-pricing scenario 20% and arrived at a fair value of \$6.35 per share. The weighting assigned to the IPO scenario in the February 28, 2011 valuation is higher than the 75% weighting assigned to the IPO scenario in the October 31, 2010 valuation primarily as a result of

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our filing of the registration statement of which this prospectus forms a part on February 11, 2011. The analysis continued to reflect the option-pricing scenario to reflect market and execution risk associated with a planned IPO.

In addition, on May 11, 2011, the underwriters of our offering presented their valuation analysis of our common stock to our board of directors and recommended an estimated price range for this offering of \$7.00 to \$9.00 per share, which recommendation was accepted by our board of directors. The most recent valuation used for the stock options granted on March 31, 2011 and between April 14 and April 22, 2011 does not materially differ from the \$8.00 midpoint of the initial price range shown on the cover page of the preliminary prospectus included in the Registration Statement filed on June 2, 2011, particularly when taking into account the continued lack of liquidity of our common stock and the remaining execution risk associated with a planned IPO as of the grant dates.

Accounting for Income Taxes

We account for our income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or in our income tax returns. Deferred income taxes are recognized for differences between financial reporting and tax bases of assets and liabilities at the enacted statutory income tax rates in effect for the years in which the temporary differences are expected to reverse. The effect on deferred taxes of a change in income tax rates is recognized in income in the period that includes the enactment date. We evaluate the realizability of our deferred tax assets and valuation allowances are provided when necessary to reduce net deferred tax assets to the amounts expected to be realized.

We operate in various tax jurisdictions and are subject to examination by various tax authorities. We provide tax contingencies whenever it is deemed probable that a tax asset has been impaired or a tax liability has been incurred for events such as tax claims or changes in tax laws. Tax contingencies are based upon their technical merits, relevant tax law and the specific facts and circumstances as of each reporting period. Changes in facts and circumstances could result in material changes to the amounts recorded for such tax contingencies.

We recognize a tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. We will recognize interest and penalties related to unrecognized tax benefits in our income tax (benefit) provision in the accompanying statement of operations.

We calculate our current and deferred income tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed in subsequent years. Adjustments based on filed income tax returns are recorded when identified. The amount of income taxes we pay is subject to examination by U.S. federal and state tax authorities. Our estimate of the potential outcome of any uncertain tax issue is subject to management's assessment of relevant risks, facts and circumstances existing at that time. To the extent that our assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made.

Quantitative and Qualitative Disclosure About Market Risk

We have operations wholly within the United States and we are exposed to market risks in the ordinary course of our business, including interest rate and inflation risks.

Interest Rate Fluctuation Risk

Our exposure to interest rates also relates to the increase or decrease in the amount of interest we must pay on our outstanding debt instruments. On May 13, 2011, we entered into a \$30 million credit facility with a syndicate

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of financial institutions. Any outstanding borrowings under the credit facility bear a variable interest rate of either (i) an adjusted London Interbank Offer, or LIBO, rate plus (A) 3.00% (if the debt outstanding is greater than or equal to \$15 million) or (B) 2.75% (if the debt outstanding is less than \$15 million) or (ii) an alternate base rate plus (x) 2.00% (if the debt outstanding is greater than or equal to \$15 million) or (y) 1.75% (if the debt outstanding is less than \$15 million). The alternate base rate is the greatest of the prime rate, the federal funds effect rate plus 0.5% and the adjusted LIBO rate plus 1%. The adjusted LIBO rate is the LIBO rate for a particular interest period multiplied by the statutory reserve rate. As of May 13, 2011, we had drawn \$9 million under the credit facility. Based upon our outstanding borrowings as of May 13, 2011, if interest rates increased by 100 basis points, the change would increase our interest expense annually by \$90,000.

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Because our cash and cash equivalents have a relatively short maturity, our portfolio's fair value is relatively insensitive to interest rate changes. We determined that the increase in yield from potentially investing our cash and cash equivalents in longer-term investments did not warrant a change in our investment strategy. In future periods, we will continue to evaluate our investment policy in order to ensure that we continue to meet our overall objectives.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Recently Issued and Adopted Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Updated, or ASU, 2009-13 regarding ASC Subtopic 605-25, *Revenue Recognition - Multiple-element Arrangements*. This ASU addresses criteria for separating the consideration in multiple-element arrangements. ASU 2009-13 requires companies to allocate the overall consideration to each deliverable by using a BEBP of individual deliverables in the arrangement in the absence of VSOE or TPE of the selling price. The changes under ASU 2009-13 are effective prospectively for revenue arrangements entered into or materially modified subsequent to adoption. We adopted the changes under ASU 2009-13 effective February 1, 2011. Under the previous accounting guidance, we treated our multiple element arrangements as a single unit of accounting as we generally did not have VSOE for our undelivered elements. Under the new guidance, we use BEBP when neither VSOE nor TPE is available. As a result, we are able to recognize the relative fair value of the elements as they are delivered, assuming other revenue recognition criteria are met. As a result of implementing ASU 2009-13, we recognized \$1.6 million as revenue in the three months ended April 30, 2011 that would have been deferred under the previous guidance for multiple element arrangements.

Effective October 31, 2009, we adopted *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. This standard establishes only two levels of GAAP, authoritative and non-authoritative. The FASB Accounting Standards Codification, or the Codification, became the source of authoritative, non-governmental GAAP, except for rules and interpretive releases of the SEC, which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification became non-authoritative. As the Codification was not intended to change or alter existing GAAP, it did not have any impact on our financial statements.

Effective February 1, 2010, we adopted new authoritative guidance on fair value measurements and disclosures. The new guidance requires additional disclosures regarding fair value measurements, amends disclosures about postretirement benefit plan assets, and provides clarification

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regarding the level of disaggregation of fair value disclosures by investment class. This guidance is effective for interim and annual

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reporting periods beginning after December 15, 2009, except for certain Level 3 activity disclosure requirements that will be effective for reporting periods beginning after December 15, 2010. Accordingly, we adopted this new guidance beginning February 1, 2010, except for the additional Level 3 requirements, which will be adopted in 2011. Level 3 assets and liabilities are those whose fair value inputs are unobservable and reflect management's best estimate.