

Edgar Filing: Pandora Media, Inc. - Form 10-Q

Pandora Media, Inc.

Form 10-Q

July 26, 2016

false--12-31Q2201610-Q0001230276YesLarge Accelerated FilerPandora Media,

Inc.P10D554000P90DP90D87000003P6M0.0300110000021650002345000002249704122310303032249704122310303030.0

0001230276 2016-01-01 2016-06-30 0001230276 2016-07-22 0001230276 2016-06-30 0001230276 2015-12-31
0001230276 2015-01-01 2015-06-30 0001230276 2015-04-01 2015-06-30 0001230276 2016-04-01 2016-06-30
0001230276 2015-06-30 0001230276 2014-12-31 0001230276 us-gaap:MoneyMarketFundsMember 2015-12-31
0001230276 us-gaap:CommercialPaperMember 2015-12-31 0001230276 us-gaap:CorporateDebtSecuritiesMember
2015-12-31 0001230276 us-gaap:USGovernmentAgenciesDebtSecuritiesMember 2015-12-31 0001230276
us-gaap:USGovernmentAgenciesDebtSecuritiesMember 2015-12-31 0001230276
us-gaap:CorporateDebtSecuritiesMember 2015-12-31 0001230276 us-gaap:CorporateDebtSecuritiesMember
2016-06-30 0001230276 us-gaap:CommercialPaperMember 2016-06-30 0001230276 us-gaap:CashMember
2015-12-31 0001230276 us-gaap:CorporateDebtSecuritiesMember 2016-06-30 0001230276 us-gaap:CashMember
2016-06-30 0001230276 us-gaap:USGovernmentAgenciesDebtSecuritiesMember 2016-06-30 0001230276
us-gaap:MoneyMarketFundsMember 2016-06-30 0001230276 us-gaap:FairValueInputsLevel2Member
us-gaap:MoneyMarketFundsMember 2015-12-31 0001230276 us-gaap:FairValueInputsLevel1Member
us-gaap:USGovernmentAgenciesDebtSecuritiesMember 2015-12-31 0001230276
us-gaap:FairValueInputsLevel1Member us-gaap:CorporateDebtSecuritiesMember 2015-12-31 0001230276
us-gaap:FairValueInputsLevel1Member 2015-12-31 0001230276 us-gaap:FairValueInputsLevel2Member 2015-12-31
0001230276 us-gaap:FairValueInputsLevel1Member us-gaap:MoneyMarketFundsMember 2015-12-31 0001230276
us-gaap:FairValueInputsLevel2Member us-gaap:USGovernmentAgenciesDebtSecuritiesMember 2015-12-31
0001230276 us-gaap:FairValueInputsLevel2Member us-gaap:CommercialPaperMember 2015-12-31 0001230276
us-gaap:FairValueInputsLevel2Member us-gaap:CorporateDebtSecuritiesMember 2015-12-31 0001230276
us-gaap:FairValueInputsLevel1Member us-gaap:CommercialPaperMember 2015-12-31 0001230276
us-gaap:FairValueInputsLevel1Member 2016-06-30 0001230276 us-gaap:FairValueInputsLevel2Member
us-gaap:CommercialPaperMember 2016-06-30 0001230276 us-gaap:FairValueInputsLevel2Member
us-gaap:CorporateDebtSecuritiesMember 2016-06-30 0001230276 us-gaap:FairValueInputsLevel2Member
2016-06-30 0001230276 us-gaap:FairValueInputsLevel1Member us-gaap:CommercialPaperMember 2016-06-30
0001230276 us-gaap:FairValueInputsLevel1Member us-gaap:CorporateDebtSecuritiesMember 2016-06-30
0001230276 us-gaap:FairValueInputsLevel2Member us-gaap:MoneyMarketFundsMember 2016-06-30 0001230276
us-gaap:FairValueInputsLevel1Member us-gaap:MoneyMarketFundsMember 2016-06-30 0001230276
us-gaap:FairValueInputsLevel3Member 2016-06-30 0001230276 us-gaap:FairValueInputsLevel3Member 2015-12-31
0001230276 us-gaap:CostOfSalesMember p:Pre1972CopyrightLitigationMember 2015-01-01 2015-12-31
0001230276 p:Pre1972CopyrightLitigationMember 2015-10-01 2015-10-31 0001230276
p:Pre1972CopyrightLitigationMember 2016-01-01 2016-06-30 0001230276 p:Pre1972CopyrightLitigationMember
us-gaap:ScenarioForecastMember 2016-01-01 2016-12-31 0001230276 p:Pre1972CopyrightLitigationMember
2015-01-01 2015-09-30 0001230276 p:Pre1972CopyrightLitigationMember 2016-03-01 2016-03-31 0001230276
us-gaap:PatentsMember 2016-06-30 0001230276 us-gaap:LicensingAgreementsMember 2015-12-31 0001230276
p:CustomerRelationshipsVenuesAndPromotersMember 2015-12-31 0001230276
p:CustomerRelationshipsVenuesAndPromotersMember 2016-06-30 0001230276
us-gaap:DevelopedTechnologyRightsMember 2016-06-30 0001230276 us-gaap:TradeNamesMember 2015-12-31
0001230276 us-gaap:DevelopedTechnologyRightsMember 2015-12-31 0001230276 us-gaap:PatentsMember
2015-12-31 0001230276 us-gaap:TradeNamesMember 2016-06-30 0001230276
p:CustomerRelationshipsUsersMember 2016-06-30 0001230276 us-gaap:LicensingAgreementsMember 2016-06-30
0001230276 p:CustomerRelationshipsUsersMember 2015-12-31 0001230276
p:ConvertibleSeniorNotesDue2020Member us-gaap:ConvertibleDebtMember 2016-01-01 2016-06-30 0001230276
p:ConvertibleSeniorNotesDue2020Member us-gaap:ConvertibleDebtMember 2016-04-01 2016-06-30 0001230276
p:ConvertibleSeniorNotesDue2020Member us-gaap:ConvertibleDebtMember 2016-06-30 0001230276
p:ConvertibleSeniorNotesDue2020Member us-gaap:ConvertibleDebtMember 2015-12-09 0001230276
p:ConvertibleSeniorNotesDue2020Member us-gaap:ConvertibleDebtMember 2015-12-09 2015-12-09 0001230276

Edgar Filing: Pandora Media, Inc. - Form 10-Q

p:ConvertibleSeniorNotesDue2020Member us-gaap:DebtInstrumentRedemptionPeriodOneMember
us-gaap:ConvertibleDebtMember 2015-12-09 2015-12-09 0001230276 us-gaap:LineOfCreditMember 2016-06-30
0001230276 us-gaap:LetterOfCreditMember 2016-06-30 0001230276 p:ConvertibleSeniorNotesDue2020Member
us-gaap:DebtInstrumentRedemptionPeriodTwoMember us-gaap:ConvertibleDebtMember 2015-12-09 2015-12-09
0001230276 p:ConvertibleSeniorNotesDue2020Member us-gaap:DebtInstrumentRedemptionPeriodThreeMember
us-gaap:ConvertibleDebtMember 2015-12-09 2015-12-09 0001230276 p:ConvertibleSeniorNotesDue2020Member
us-gaap:ConvertibleDebtMember 2015-12-31 0001230276 p:MarketStockUnitsMSUsMember
us-gaap:MaximumMember us-gaap:ShareBasedCompensationAwardTrancheThreeMember 2015-03-01 2015-03-31
0001230276 p:MarketStockUnitsMSUsMember us-gaap:ShareBasedCompensationAwardTrancheOneMember
2015-01-01 2015-12-31 0001230276 us-gaap:EmployeeStockMember 2015-01-01 2015-06-30 0001230276
p:MarketStockUnitsMSUsMember 2016-01-01 2016-06-30 0001230276 p:MarketStockUnitsMSUsMember
2015-01-01 2015-06-30 0001230276 us-gaap:PerformanceSharesMember us-gaap:MinimumMember 2016-04-30
0001230276 us-gaap:EmployeeStockMember 2016-01-01 2016-06-30 0001230276 us-gaap:EmployeeStockMember
2016-04-01 2016-06-30 0001230276 us-gaap:RestrictedStockUnitsRSUMember 2015-01-01 2015-06-30 0001230276
us-gaap:EmployeeStockMember 2015-04-01 2015-06-30 0001230276 us-gaap:PerformanceSharesMember
2016-01-01 2016-06-30 0001230276 p:MarketStockUnitsMSUsMember 2015-03-01 2015-03-31 0001230276
us-gaap:RestrictedStockUnitsRSUMember 2016-01-01 2016-06-30 0001230276
us-gaap:RestrictedStockUnitsRSUMember 2016-04-01 2016-06-30 0001230276 p:MarketStockUnitsMSUsMember
us-gaap:MaximumMember p:ShareBasedCompensationAwardTrancheOneandTwoMember 2015-03-01 2015-03-31
0001230276 us-gaap:EmployeeStockMember 2016-06-30 0001230276
p:EmployeeAndNonEmployeeStockOptionsMember 2016-01-01 2016-06-30 0001230276
p:EmployeeAndNonEmployeeStockOptionsMember 2016-04-01 2016-06-30 0001230276
p:MarketStockUnitsMSUsMember 2015-01-01 2015-12-31 0001230276 p:MarketStockUnitsMSUsMember
2016-04-01 2016-06-30 0001230276 us-gaap:RestrictedStockUnitsRSUMember 2015-04-01 2015-06-30 0001230276
us-gaap:EmployeeSeveranceMember 2016-01-01 2016-06-30 0001230276 p:MarketStockUnitsMSUsMember
2015-04-01 2015-06-30 0001230276 p:EmployeeAndNonEmployeeStockOptionsMember 2015-04-01 2015-06-30
0001230276 p:EmployeeAndNonEmployeeStockOptionsMember 2015-01-01 2015-06-30 0001230276
us-gaap:ResearchAndDevelopmentExpenseMember 2015-04-01 2015-06-30 0001230276
us-gaap:SellingAndMarketingExpenseMember 2015-01-01 2015-06-30 0001230276
us-gaap:ResearchAndDevelopmentExpenseMember 2016-04-01 2016-06-30 0001230276
us-gaap:GeneralAndAdministrativeExpenseMember 2016-04-01 2016-06-30 0001230276
us-gaap:SellingAndMarketingExpenseMember 2015-04-01 2015-06-30 0001230276 us-gaap:CostOfSalesMember
2015-04-01 2015-06-30 0001230276 p:ServiceAndProcessingCostsMember 2016-04-01 2016-06-30 0001230276
p:ServiceAndProcessingCostsMember 2015-01-01 2015-06-30 0001230276 p:ServiceAndProcessingCostsMember
2015-04-01 2015-06-30 0001230276 us-gaap:CostOfSalesMember 2016-01-01 2016-06-30 0001230276
us-gaap:GeneralAndAdministrativeExpenseMember 2015-04-01 2015-06-30 0001230276
us-gaap:CostOfSalesMember 2015-01-01 2015-06-30 0001230276
us-gaap:GeneralAndAdministrativeExpenseMember 2015-01-01 2015-06-30 0001230276
us-gaap:SellingAndMarketingExpenseMember 2016-04-01 2016-06-30 0001230276 us-gaap:CostOfSalesMember
2016-04-01 2016-06-30 0001230276 us-gaap:ResearchAndDevelopmentExpenseMember 2016-01-01 2016-06-30
0001230276 us-gaap:ResearchAndDevelopmentExpenseMember 2015-01-01 2015-06-30 0001230276
us-gaap:SellingAndMarketingExpenseMember 2016-01-01 2016-06-30 0001230276
p:ServiceAndProcessingCostsMember 2016-01-01 2016-06-30 0001230276
us-gaap:GeneralAndAdministrativeExpenseMember 2016-01-01 2016-06-30 0001230276
us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2016-04-01 2016-06-30 0001230276
us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2015-04-01 2015-06-30 0001230276
us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2016-01-01 2016-06-30 0001230276
us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2015-01-01 2015-06-30 0001230276
us-gaap:PerformanceSharesMember 2016-04-01 2016-04-30 0001230276 us-gaap:PerformanceSharesMember
us-gaap:ShareBasedCompensationAwardTrancheOneMember 2016-04-01 2016-04-30 0001230276
us-gaap:PerformanceSharesMember 2015-01-01 2015-06-30 0001230276 us-gaap:PerformanceSharesMember

(510) 451-4100

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares of registrant's common stock outstanding as of July 22, 2016 was: 231,041,580.

Table of Contents

Pandora Media, Inc.

FORM 10-Q Quarterly Report

Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of December 31, 2015 and June 30, 2016</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2015 and 2016</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended June 30, 2015 and 2016</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2015 and 2016</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>22</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>38</u>
<u>Item 4. Controls and Procedures</u>	<u>39</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>40</u>
<u>Item 1A. Risk Factors</u>	<u>40</u>
<u>Item 5. Other Information</u>	<u>41</u>
<u>Item 6. Exhibits</u>	<u>42</u>
<u>Signatures</u>	<u>43</u>

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Pandora Media, Inc.****Condensed Consolidated Balance Sheets****(in thousands, except share and per share amounts)****(unaudited)**

	As of December 31, 2015	As of June 30, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 334,667	\$ 238,367
Short-term investments	35,844	54,800
Accounts receivable, net of allowance of \$2,165 at December 31, 2015 and \$2,345 at June 30, 2016	277,075	263,654
Prepaid expenses and other current assets	35,920	43,286
Total current assets	683,506	600,107
Long-term investments	46,369	18,153
Property and equipment, net	66,370	102,016
Goodwill	303,875	306,715
Intangible assets, net	110,745	100,705
Other long-term assets	29,792	31,478
Total assets	\$ 1,240,657	\$ 1,159,174
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 17,897	\$ 6,132
Accrued liabilities	37,185	29,723
Accrued royalties	97,390	123,583
Accrued compensation	43,788	48,971
Deferred revenue	19,939	28,751
Other current liabilities	15,632	17,432
Total current liabilities	231,831	254,592
Long-term debt, net	234,577	243,483
Other long-term liabilities	30,862	32,804
Total liabilities	497,270	530,879
Stockholders' equity		
Common stock: 224,970,412 shares issued and outstanding at December 31, 2015 and 231,030,303 at June 30, 2016	23	23
Additional paid-in capital	1,110,539	1,186,777
Accumulated deficit	(366,658)	(558,093)
Accumulated other comprehensive loss	(517)	(412)
Total stockholders' equity	743,387	628,295
Total liabilities and stockholders' equity	\$ 1,240,657	\$ 1,159,174

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

Table of Contents

Pandora Media, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2015	2016	2015	2016
Revenue				
Advertising	\$ 230,921	\$ 265,126	\$ 409,660	\$ 485,434
Subscription and other	54,639	55,125	106,664	109,857
Ticketing service	—	22,771	—	45,036
Total revenue	285,560	343,022	516,324	640,327
Cost of revenue				
Cost of revenue - Content acquisition costs	130,134	176,633	256,157	347,897
Cost of revenue - Other	20,043	24,833	36,276	45,832
Cost of revenue - Ticketing service	—	15,259	—	29,905
Total cost of revenue	150,177	216,725	292,433	423,634
Gross profit	135,383	126,297	223,891	216,693
Operating expenses				
Product development	18,742	33,808	34,617	69,654
Sales and marketing	94,035	123,812	178,309	241,434
General and administrative	38,812	40,562	75,566	86,858
Total operating expenses	151,589	198,182	288,492	397,946
Loss from operations	(16,206)	(71,885)	(64,601)	(181,253)
Interest expense	(124)	(6,247)	(255)	(12,422)
Other income, net	380	255	708	1,117
Total other income (expense), net	256	(5,992)	453	(11,305)
Loss before benefit from (provision for) income taxes	(15,950)	(77,877)	(64,148)	(192,558)
Benefit from (provision for) income taxes	(115)	1,544	(174)	1,123
Net loss	\$(16,065)	\$(76,333)	\$(64,322)	\$(191,435)
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	211,742	229,745	210,840	228,202
Net loss per share, basic and diluted	\$(0.08)	\$(0.33)	\$(0.31)	\$(0.84)

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

Table of Contents

Pandora Media, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2015	2016	2015	2016
Net loss	\$(16,065)	\$(76,333)	\$(64,322)	\$(191,435)
Change in foreign currency translation adjustment	(48)	(55)	(147)	(288)
Change in net unrealized gains on marketable securities	(283)	88	275	393
Other comprehensive income (loss)	(331)	33	128	105
Total comprehensive loss	\$(16,396)	\$(76,300)	\$(64,194)	\$(191,330)

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

Table of Contents

Pandora Media, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Six months ended	
	June 30,	
	2015	2016
Operating activities		
Net loss	\$(64,322)	\$(191,435)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	9,365	27,637
Stock-based compensation	50,679	71,087
Amortization of premium on investments, net	1,229	247
Other operating activities	944	1,474
Amortization of debt discount	—	8,938
Changes in operating assets and liabilities		
Accounts receivable	(16,123)	12,139
Prepaid expenses and other assets	(2,104)	(16,140)
Accounts payable, accrued and other current liabilities	11,959	(17,409)
Accrued royalties	7,697	26,177
Accrued compensation	5,897	5,497
Other long-term liabilities	(1,596)	1
Deferred revenue	12,685	8,812
Reimbursement of cost of leasehold improvements	749	4,397
Net cash provided by (used in) operating activities	17,059	(58,578)
Investing activities		
Purchases of property and equipment	(14,578)	(34,564)
Internal-use software costs	(3,369)	(14,310)
Changes in restricted cash	—	(250)
Purchases of investments	(111,541)	(11,091)
Proceeds from maturities of investments	132,119	20,007
Proceeds from sale of investments	3,662	500
Payments related to acquisition, net of cash acquired	(200)	(676)
Net cash provided by (used in) investing activities	6,093	(40,384)
Financing activities		
Proceeds from employee stock purchase plan	3,275	3,837
Proceeds from exercise of stock options	2,862	1,873
Payment of debt issuance costs	—	(32)
Tax payments from net share settlements of restricted stock units	(907)	(2,761)
Net cash provided by financing activities	5,230	2,917
Effect of exchange rate changes on cash and cash equivalents	(236)	(255)
Net increase (decrease) in cash and cash equivalents	28,146	(96,300)
Cash and cash equivalents at beginning of period	175,957	334,667
Cash and cash equivalents at end of period	\$204,103	\$238,367
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	\$219	\$3,228
Purchases of property and equipment recorded in accounts payable and accrued liabilities	\$3,637	\$5,308

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

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of Business and Basis of Presentation

Pandora

Pandora is the world's most powerful music discovery platform, offering a personalized experience for each of our listeners wherever and whenever they want to listen to music—whether through earbuds, car speakers or live on stage. Our vision is to be the definitive source of music discovery and enjoyment for billions. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We offer both local and national advertisers the opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. We also generate revenue by offering an advertising-free subscription service which we call Pandora One. We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010. Our principal operations are located in the United States, and we also operate in Australia, New Zealand and Canada.

Ticketing Service

Ticketfly is a leading live events technology company that provides ticketing and marketing software and services for venues and event promoters across North America. Ticketfly's ticketing, digital marketing and analytics software helps promoters book talent, sell tickets and drive in-venue revenue, while Ticketfly's consumer tools help fans find and purchase tickets to events. Ticketfly's revenue primarily consists of service and merchant processing fees from ticketing operations. We completed the acquisition of Ticketfly on October 31, 2015.

As used herein, "Pandora," "we," "our," the "Company" and similar terms include Pandora Media, Inc. and its subsidiaries, unless the context indicates otherwise.

Basis of Presentation

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") along with the instructions to Form 10-Q and Article 10 of Securities and Exchange Commission ("SEC") Regulation S-X, and include the accounts of Pandora and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of our management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of our financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. We have reclassified certain amounts from the accounts payable, accrued and other current liabilities line item to the long-term liabilities line item of our condensed consolidated statements of cash flows. We have also reclassified internal-use software costs from the purchases of property and equipment line item to the internal-use software costs line item of our condensed consolidated statements of cash flows. Lastly, we have reclassified interest expense from the other income (expense), net line item to the interest expense line item of our condensed consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Estimates are used in several areas including, but not limited to determining accrued royalties, selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, the fair value of stock options, market stock units ("MSUs"), stock-settled performance-based RSUs ("PSUs") and the Employee Stock Purchase Plan ("ESPP"), the provision for (benefit from) income taxes and the impact of forfeitures on stock-based compensation. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements could be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP and does not require management

7

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result.

2. Summary of Significant Accounting Policies

There have been no material changes to our significant accounting policies as compared to those described in our Annual Report on Form 10-K for the year ended December 31, 2015.

Concentration of Credit Risk

For the three and six months ended June 30, 2015 and 2016, we had no customers that accounted for more than 10% of our total revenue. As of December 31, 2015 and June 30, 2016, we had no customers that accounted for more than 10% of our total accounts receivable.

Recently Issued Accounting Standards

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, *Compensation - Stock Compensation (Topic 718)* ("ASU 2016-09"). ASU 2016-09 requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. Additionally, it allows an employer to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within that fiscal year, although early adoption is permitted. We are currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial statements upon adoption.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, *Going Concern (Subtopic 205-40)* ("ASU 2014-15"). ASU 2014-15 requires management of all entities to evaluate whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued when applicable). The guidance is effective for fiscal years beginning after December 15, 2016 and for interim periods within that fiscal year. We do not expect the adoption of this guidance to have a material effect on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-9, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-9"). ASU 2014-9 outlines a single comprehensive model for entities to use in accounting for revenue. Under the guidance, revenue is recognized when a company transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The standard may be effective for public entities with annual and interim reporting periods beginning after December 15, 2017. Entities have the option of using either a full retrospective or a modified retrospective approach to adopt the guidance. We are currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial statements upon adoption.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 requires lessees to put most leases on their balance sheets but recognize expenses on their income statement and eliminates the real estate-specific provisions for all entities. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial

statements upon adoption.

3. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments consisted of the following:

8

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

	As of December 31, 2015 (in thousands)	As of June 30, 2016
Cash and cash equivalents		
Cash	\$104,361	\$67,756
Money market funds	180,021	112,607
Commercial paper	31,089	47,684
Corporate debt securities	2,000	10,320
U.S. government and government agency debt securities	17,196	—
Total cash and cash equivalents	\$334,667	\$238,367
Short-term investments		
Commercial paper	\$4,792	\$3,998
Corporate debt securities	31,052	50,802
Total short-term investments	\$35,844	\$54,800
Long-term investments		
Corporate debt securities	\$46,369	\$18,153
Total long-term investments	\$46,369	\$18,153
Cash, cash equivalents and investments	\$416,880	\$311,320

Our short-term investments have maturities of twelve months or less and are classified as available-for-sale. Our long-term investments have maturities of greater than twelve months and are classified as available-for-sale.

The following tables summarize our available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of December 31, 2015 and June 30, 2016.

	As of December 31, 2015			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Money market funds	\$180,021	\$ —	\$ —	\$180,021
Commercial paper	35,881	—	—	35,881
Corporate debt securities	79,760	8	(347)	79,421
U.S. government and government agency debt securities	17,198	—	(2)	17,196
Total cash equivalents and marketable securities	\$312,860	\$ 8	\$ (349)	\$312,519

	As of June 30, 2016			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Money market funds	\$112,607	\$ —	\$ —	\$112,607
Commercial paper	51,682	—	—	51,682
Corporate debt securities	79,223	69	(17)	79,275
Total cash equivalents and marketable securities	\$243,512	\$ 69	\$ (17)	\$243,564

The following table presents available-for-sale investments by contractual maturity date as of December 31, 2015 and June 30, 2016.

9

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

	As of December 31, 2015	
	Adjusted Cost	Fair Value
	(in thousands)	
Due in one year or less	\$266,205	\$ 266,150
Due after one year through three years	46,655	46,369
Total	\$312,860	\$ 312,519
	As of June 30, 2016	
	Adjusted Cost	Fair Value
	(in thousands)	
Due in one year or less	\$225,395	\$ 225,411
Due after one year through three years	18,117	18,153
Total	\$243,512	\$ 243,564

The following tables summarize our available-for-sale securities' fair value and gross unrealized losses aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position as of December 31, 2015 and June 30, 2016.

	As of December 31, 2015					
	Twelve Months or Less		More than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Corporate debt securities	\$64,804	\$ (293)	\$8,531	\$ (54)	\$73,335	\$ (347)
U.S. government and government agency debt securities	16,241	(2)	—	—	16,241	(2)
Total	\$81,045	\$ (295)	\$8,531	\$ (54)	\$89,576	\$ (349)

	As of June 30, 2016					
	Twelve Months or Less		More than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Corporate debt securities	\$17,796	\$ (7)	\$9,763	\$ (10)	\$27,559	\$ (17)
Total	\$17,796	\$ (7)	\$9,763	\$ (10)	\$27,559	\$ (17)

Our investment policy requires investments to be investment grade, primarily rated "A1" by Standard & Poor's or "P1" by Moody's or better for short-term investments and rated "A" by Standard & Poor's or "A2" by Moody's or better for long-term investments, with the objective of minimizing the potential risk of principal loss. In addition, the investment policy limits the amount of credit exposure to any one issuer.

The unrealized losses on our available-for-sale securities as of June 30, 2016 were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of June 30, 2016, we owned 25 securities that were in an unrealized loss position. Based on our cash flow needs, we may be required to sell a portion of these securities prior to maturity. However, we expect to recover the full carrying value of these securities. As a result, no portion of the unrealized losses at June 30, 2016 is deemed to be other-than-temporary and the unrealized losses are not deemed to be credit losses. When evaluating the investments for other-than-temporary impairment, we review factors such as the length of time and extent

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and our intent to sell, or whether it is more likely than not we will be required to sell, the investment before recovery of the investment's amortized cost basis. During the three and six months ended June 30, 2016, we did not recognize any impairment charges. During the three and six months ended June 30, 2016, we had proceeds from the sale of available-for-sale securities of \$0.5 million. We did not recognize a realized gain or loss in connection with these sales.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)****4. Fair Value**

We record cash equivalents and short-term investments at fair value. Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. Fair value measurements are required to be disclosed by level within the following fair value hierarchy:

Level 1 — Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 — Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level 3 — Inputs lack observable market data to corroborate management's estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

When determining fair value, whenever possible we use observable market data and rely on unobservable inputs only when observable market data is not available.

The fair value of these financial assets and liabilities was determined using the following inputs at December 31, 2015 and June 30, 2016:

	As of December 31, 2015		
	Fair Value Measurement Using		
	Quoted	Significant	
	Prices in	Other	
	Active Markets	Observable	Total
	for Identical	Inputs	
	Instruments	(Level 2)	
	(Level 1)		
	(in thousands)		
Assets			
Money market funds	\$ 180,021	\$ —	\$ 180,021
Commercial paper	—	35,881	35,881
Corporate debt securities	—	79,421	79,421
U.S. government and government agency debt securities	—	17,196	17,196
Total assets measured at fair value	\$ 180,021	\$ 132,498	\$ 312,519

	As of June 30, 2016		
	Fair Value Measurement Using		
	Quoted	Significant	Total
	Prices in	Other	
	Active Markets	Observable	
	for Identical	Inputs	
	Instruments	(Level 2)	

Edgar Filing: Pandora Media, Inc. - Form 10-Q

(Level 1)
(in thousands)

Assets			
Money market funds	\$ 112,607	\$ —	\$ 112,607
Commercial paper	—	51,682	51,682
Corporate debt securities	—	79,275	79,275
Total assets measured at fair value	\$ 112,607	\$ 130,957	\$ 243,564

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

Our money market funds are classified as Level 1 within the fair value hierarchy because they are valued primarily using quoted market prices. Our other cash equivalents and short-term investments are classified as Level 2 within the fair value hierarchy because they are valued using professional pricing sources for identical or comparable instruments, rather than direct observations of quoted prices in active markets. As of December 31, 2015 and June 30, 2016, we held no Level 3 assets or liabilities.

Refer to Note 7, "Debt Instruments," for the carrying amount and estimated fair value of our convertible senior notes, which are not recorded at fair value as of June 30, 2016.

5. Commitments and Contingencies

Legal Proceedings

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

Pre-1972 copyright litigation

On April 17, 2014, UMG Recordings, Inc., Sony Music Entertainment, Capitol Records, LLC, Warner Music Group Corp. and ABKCO Music and Records, Inc. filed suit against Pandora Media Inc. in the Supreme Court of the State of New York. The complaint claims common law copyright infringement and unfair competition arising from allegations that Pandora owes royalties for the public performance of sound recordings recorded prior to February 15, 1972.

In October 2015, the parties reached an agreement ("pre-1972 settlement") whereby we agreed to pay the plaintiffs a total of \$90 million. The settlement resolves all past claims as to our use of pre-1972 recordings owned or controlled by the plaintiffs and enables us, without any additional payment, to reproduce, perform and broadcast such recordings in the United States through December 31, 2016. This agreement was approved by our board of directors and executed on October 21, 2015. Pursuant to this settlement, we paid the plaintiffs \$60 million in October 2015 and the plaintiffs dismissed the case with prejudice. As a result, cost of revenue - content acquisition costs increased by \$65.4 million in the twelve months ended December 31, 2015, of which \$57.9 million was related to a one-time cumulative charge to cost of revenue - content acquisition costs related to pre-1972 spins played through September 30, 2015. The remaining charge of \$24.6 million will be recorded in cost of revenue - content acquisition costs in 2016 based on expected streaming of pre-1972 recordings over the period. The pre-72 settlement further requires that we make four additional installment payments of \$7.5 million each. The first was paid in December 2015, the second was paid in March 2016 and the third was paid in June 2016. The remaining installment will be paid on or before October 1, 2016.

On October 2, 2014, Flo & Eddie Inc. filed a class action suit against Pandora Media Inc. in the federal district court for the Central District of California. The complaint alleges misappropriation and conversion in connection with the public performance of sound recordings recorded prior to February 15, 1972. On December 19, 2014, Pandora filed a

motion to strike the complaint pursuant to California's Anti-Strategic Lawsuit Against Public Participation ("Anti-SLAPP") statute. This motion was denied, and we have appealed the ruling to the Ninth Circuit Court of Appeals. As a result, the district court litigation has been stayed pending the Ninth Circuit's review.

On September 14, 2015, Arthur and Barbara Sheridan, et al filed a class action suit against Pandora Media, Inc. in the federal district court for the Northern District of California. The complaint alleges common law misappropriation, unfair competition, conversion, unjust enrichment and violation of California rights of publicity arising from allegations that we owe royalties for the public performance of sound recordings recorded prior to February 15, 1972. On October 28, 2015, the Court granted the parties' stipulation to stay the district court action pending the Ninth Circuit's review of Pandora's appeal in Flo & Eddie et al. v. Pandora Media, Inc., which involves similar allegations.

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

On September 16, 2015, Arthur and Barbara Sheridan, et al filed a second class action suit against Pandora Media, Inc. in the federal district court for the Southern District of New York. The complaint alleges common law copyright infringement, violation of New York right of publicity, unfair competition and unjust enrichment arising from allegations that we owe royalties for the public performance of sound recordings recorded prior to February 15, 1972. On October 28, 2015 the Court granted the parties' stipulation to stay the district court action pending the Second Circuit's review of Sirius XM's appeal in the Flo & Eddie et al. v. Sirius XM matter, which involves similar allegations.

On October 17, 2015, Arthur and Barbara Sheridan, et al filed a third class action suit against us in the federal district court for the Northern District of Illinois ("Third Class Action Suit"). The complaint alleges common law copyright infringement, violation of the Illinois Uniform Deceptive Trade Practices Act, conversion, and unjust enrichment arising from allegations that we owe royalties for the public performance of sound recordings recorded prior to February 15, 1972. On December 29, 2015, Pandora filed a motion to dismiss and motion to stay the case pending the Second Circuit's decision. The motion to stay was denied, and the motion to dismiss remains pending.

On October 19, 2015, Arthur and Barbara Sheridan, et al filed a fourth class action suit against us in the federal district court for the District of New Jersey ("Fourth Class Action Suit"). The complaint alleges common law copyright infringement, unfair competition and unjust enrichment arising from allegations that we owe royalties for the public performance of sound recordings recorded prior to February 15, 1972. On December 29, 2015, Pandora filed a motion to dismiss and motion to stay the case pending the Second Circuit's decision. On March 16, 2016, the district court granted the motion to stay.

The outcome of any litigation is inherently uncertain. Except as noted above, including with respect to the \$90 million settlement for UMG Recordings, Inc. et al v. Pandora Media Inc. in the Supreme Court of the State of New York, we do not believe it is probable that the final outcome of the matters discussed above will, individually or in the aggregate, have a material adverse effect on our business, financial position, results of operations or cash flows; however, in light of the uncertainties involved in such matters, there can be no assurance that the outcome of each case or the costs of litigation, regardless of outcome, will not have a material adverse effect on our business. In particular, rate court proceedings could take years to complete, could be very costly and may result in current and past royalty rates that are materially less favorable than rates we currently pay or have paid in the past.

Indemnification Agreements, Guarantees and Contingencies

In the ordinary course of business, we are party to certain contractual agreements under which we may provide indemnifications of varying scope, terms and duration to customers, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of such agreements, services to be provided by us or from intellectual property infringement claims made by third parties. In addition, we have entered into indemnification agreements with directors and certain officers and employees that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers or employees. Such indemnification provisions are accounted for in accordance with guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others. To date, we have not incurred, do not anticipate incurring and therefore have not accrued for, any costs related to such indemnification provisions.

While the outcome of these matters cannot be predicted with certainty, we do not believe that the outcome of any claims under indemnification arrangements will have a material adverse effect on our financial position, results of

operations or cash flows.

6. Goodwill and Intangible Assets

During the six months ended June 30, 2016, we completed a business combination that was not material to our condensed consolidated financial statements. During the three months ended June 30, 2016, we made an adjustment to goodwill and deferred tax liabilities as a result of the impact of final pre-acquisition Ticketfly income tax returns filed. The changes in the carrying amount of goodwill for the six months ended June 30, 2016, are as follows:

14

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

	Goodwill (in thousands)
Balance as of December 31, 2015	\$ 303,875
Goodwill resulting from business combination and purchase price adjustments	2,840
Balance as of June 30, 2016	\$ 306,715

The following summarizes information regarding the gross carrying amounts and accumulated amortization of intangible assets.

	As of December 31, 2015			As of June 30, 2016		
	Gross Carrying Amount (in thousands)	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount (in thousands)	Accumulated Amortization	Net Carrying Value
Finite-lived intangible assets						
Patents	\$8,030	\$ (1,824)	\$ 6,206	\$8,030	\$ (2,190)	\$ 5,840
Developed technology	56,050	(1,265)	54,785	56,166	(7,431)	48,735
Customer relationships - clients	37,300	(777)	36,523	37,400	(3,131)	34,269
Customer relationships - users	1,940	(318)	1,622	1,940	(803)	1,137
Trade names	11,720	(304)	11,416	11,735	(1,204)	10,531
Total finite-lived intangible assets	\$ 115,040	\$ (4,488)	\$ 110,552	\$ 115,271	\$ (14,759)	\$ 100,512
Indefinite-lived intangible assets						
FCC license - Broadcast Radio	\$ 193	\$ —	\$ 193	\$ 193	\$ —	\$ 193
Total intangible assets	\$ 115,233	\$ (4,488)	\$ 110,745	\$ 115,464	\$ (14,759)	\$ 100,705

Amortization expense of intangible assets was \$0.2 million and \$5.1 million for the three months ended June 30, 2015 and 2016. Amortization expense of intangible assets was \$0.4 million and \$10.3 million for the six months ended June 30, 2015 and 2016.

The following is a schedule of future amortization expense related to finite-lived intangible assets as of June 30, 2016.

	As of June 30, 2016 (in thousands)
Remainder of 2016	\$ 10,276
2017	20,118
2018	17,654
2019	17,129
2020	15,896
Thereafter	19,439
Total future amortization expense	\$ 100,512

7. Debt Instruments

Long-term debt, net consisted of the following:

15

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

	As of December 31, 2015	As of June 30, 2016
	(in thousands)	
1.75% convertible senior notes due 2020	\$345,000	\$345,000
Unamortized discount on convertible senior notes	(110,423)	(101,517)
Long-term debt, net	\$234,577	\$243,483

Convertible Debt Offering

On December 9, 2015, we completed an unregistered Rule 144A offering for the issuance of \$345.0 million aggregate principal amount of our 1.75% Convertible Senior Notes due 2020 (the “Notes”). In connection with the issuance of the Notes, we entered into capped call transactions with the initial purchaser of the Notes and an additional financial institution (“capped call transactions”).

The net proceeds from the sale of the Notes were approximately \$336.5 million, after deducting the initial purchasers' fees and other estimated expenses. We used approximately \$43.2 million of the net proceeds to pay the cost of the capped call transactions.

The Notes are unsecured, senior obligations of Pandora, and interest is payable semi-annually at a rate of 1.75% per annum. The Notes will mature on December 1, 2020, unless earlier repurchased or redeemed by Pandora or converted in accordance with their terms prior to such date. Prior to July 1, 2020, the Notes are convertible at the option of holders only upon the occurrence of specified events or during certain periods as further described below thereafter, until the second scheduled trading day prior to maturity, the Notes will be convertible at the option of holders at any time.

The conversion rate for the Notes is initially 60.9050 shares of common stock per \$1,000 principal amount of the Notes, which is equivalent to an initial conversion price of approximately \$16.42 per share of our common stock, and is subject to adjustment in certain circumstances.

We will not have the right to redeem the Notes prior to December 5, 2018. We may redeem all or any portion of the Notes for cash at our option on or after December 5, 2018 if the last reported sale price of our common stock is at least 130% of the conversion price then in effect for at least 20 trading days, whether or not consecutive, during any 30 consecutive trading day period, including the last trading day of such period, ending on, and including, any of the five trading days immediately preceding the date on which we provide notice of redemption. Any optional redemption of the Notes will be at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. The maximum number of shares of common stock the Notes are convertible into is approximately 27.3 million, and is subject to adjustment under certain circumstances.

The Notes will be convertible at the option of holders only under the following circumstances:

-

Edgar Filing: Pandora Media, Inc. - Form 10-Q

Prior to the close of business on the business day immediately preceding July 1, 2020, during any calendar quarter commencing after the calendar quarter ending on March 31, 2016 (and only during such calendar quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive), during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

Prior to the close of business on the business day immediately preceding July 1, 2020, during the five business day period after any ten consecutive trading day period (the “measurement period”) in which the trading price per \$1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day;

Prior to the business day immediately preceding July 1, 2020, upon the occurrence of specified corporate events or

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

At any time on or after July 1, 2020 until the close of business on the second scheduled trading day immediately preceding the December 1, 2020 maturity date.

Upon the occurrence of a make-whole fundamental change or if we call all or any portion of the Notes for redemption prior to July 1, 2020, we will, in certain circumstances, increase the conversion rate by a number of additional shares for a holder that elects to convert its Notes in connection with such make-whole fundamental change or during the related redemption period.

The Notes were separated into debt and equity components and assigned a fair value. The value assigned to the debt component is the estimated fair value as of the issuance date of similar debt without the conversion feature. The difference between the cash proceeds and this estimated fair value represents the value which has been assigned to the equity component and recorded as a debt discount. The debt discount is being amortized using the effective interest method over the period from the date of issuance through the December 1, 2020 maturity date.

The initial debt component of the Notes was valued at \$233.5 million, based on the contractual cash flows discounted at an appropriate market rate for non-convertible debt at the date of issuance. The carrying value of the permanent equity component reported in additional paid-in-capital was initially valued at \$103.0 million, which is net of \$2.6 million of fees and expenses allocated to the equity component.

The following table outlines the effective interest rate, contractually stated interest expense and costs related to the amortization of the discount for the Notes:

	Three months ended June 30, 2016	Six months ended June 30, 2016
	(in thousands except for effective interest rate)	
Effective interest rate	10.18 %	10.18 %
Contractually stated interest expense	\$1,509	\$3,019
Amortization of discount	\$4,503	\$8,938

The capped call transactions are expected to reduce the potential dilution to our common stock and/or offset the cash payments we would be required to make in excess of the principal amount of the converted Notes in the event that the market price of our common stock, as measured under the terms of the capped call transaction, is greater than the strike price of the capped call transaction, with such reduction and/or offset subject to a cap based on the cap price of the capped call transactions. The strike price of the capped call transactions corresponds to the initial conversion price of the Notes and is subject to certain adjustments under the terms of the capped call transactions. The capped call transactions have an initial cap price of \$25.26 per share and are subject to certain adjustments under the terms of the capped call transactions. The capped call transactions have been included as a net reduction to additional paid-in capital within stockholders' equity.

The total estimated fair value of the Notes as of June 30, 2016 was \$345.1 million. The fair value was determined using a methodology that combines direct market observations with quantitative pricing models to generate evaluated prices. We consider the fair value of the Notes to be a Level 2 measurement due to the limited trading activity of the Notes.

The closing price of our common stock was \$12.45 on June 30, 2016, which was less than the initial conversion price for the Notes of approximately \$16.42 per share. As such, the if-converted value of the Notes was less than the principal amount of \$345.0 million.

Credit Facility

We are party to a \$120.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. As of June 30, 2016, we had no borrowings outstanding, \$1.2 million in letters of credit outstanding and \$118.8 million of available borrowing capacity under the credit facility. We are in compliance with all financial covenants associated with the credit facility as of June 30, 2016.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)****8. Stock-based Compensation Plans and Awards***ESPP*

The ESPP allows eligible employees to purchase shares of our common stock through payroll deductions of up to 15% of their eligible compensation. The ESPP provides for six-month offering periods, commencing in February and August of each year.

We estimate the fair value of shares to be issued under the ESPP on the first day of the offering period using the Black-Scholes valuation model. The determination of the fair value is affected by our stock price on the first date of the offering period, as well as other assumptions including the risk-free interest rate, the estimated volatility of our stock price over the term of the offering period, the expected term of the offering period and the expected dividend rate. Stock-based compensation expense related to the ESPP is recognized on a straight-line basis over the offering period, net of estimated forfeitures.

The following assumptions for the Black-Scholes option pricing model were used to determine the per-share fair value of shares to be granted under the ESPP:

	Three months ended June 30,		Six months ended June 30,	
	2015	2016	2015	2016
Expected life (in years)	0.5	0.5	0.5	0.5
Risk-free interest rate	0.07%	0.41%	0.05 - 0.07%	0.24 - 0.41%
Expected volatility	42 %	41 %	42 %	41 %
Expected dividend yield	0 %	0 %	0 %	0 %

During the three months ended June 30, 2015 and 2016, we withheld \$1.7 million and \$2.2 million in contributions from employees and recognized \$0.6 million and \$0.7 million of stock-based compensation expense related to the ESPP, respectively. During the six months ended June 30, 2015 and 2016, we withheld \$3.3 million and \$3.8 million in contributions from employees and recognized \$1.2 million and \$1.4 million of stock-based compensation expense related to the ESPP, respectively. In the six months ended June 30, 2015 and 2016, 282,966 and 611,348 shares of common stock were issued under the ESPP. There were no shares of common stock issued under the ESPP in the three months ended June 30, 2015 and 2016.

Employee Stock-Based Awards

Our 2011 Equity Incentive Plan (the "2011 Plan") provides for the issuance of stock options, restricted stock units and other stock-based awards to our employees. The 2011 Plan is administered by the compensation committee of our board of directors.

Stock options

We measure stock-based compensation expenses for stock options 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 estimate the fair value of stock options using the Black-Scholes option-pricing model. During the three months ended June 30, 2015 and 2016, we recorded stock-based compensation expense from stock options of approximately \$2.4 million and \$2.3 million. During the six months ended June 30, 2015 and 2016, we recorded stock-based compensation expense from stock options of approximately \$5.2 million and \$9.2 million.

There were no options granted in the three and six months ended June 30, 2015 and 2016.

Restricted stock units ("RSUs")

The fair value of the restricted stock units is expensed ratably over the vesting period. RSUs typically have an initial annual cliff vest and then vest quarterly thereafter over the service period, which is generally four years. During the three

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

months ended June 30, 2015 and 2016, we recorded stock-based compensation expense from RSUs of approximately \$24.1 million and \$28.1 million. During the six months ended June 30, 2015 and 2016, we recorded stock-based compensation expense from RSUs of approximately \$43.7 million and \$59.1 million.

MSUs

In March 2015, the compensation committee of the board of directors granted performance awards consisting of market stock units to certain key executives under our 2011 Plan.

MSUs granted in March 2015 are earned as a function of Pandora's total stock return ("TSR") measured against that of the Russell 2000 Index across three performance periods:

• One-third of the target MSUs are eligible to be earned for a performance period that is the first calendar year of the MSU grant (the "One-Year Performance Period");

• One-third of the target MSUs are eligible to be earned for a performance period that is the first two calendar years of the MSU grant (the "Two-Year Performance Period"); and

• Any remaining portion of the total potential MSUs are eligible to be earned for a performance period that is the entire three calendar years of the MSU grant (the "Three-Year Performance Period").

For each performance period, a "performance multiplier" is calculated by comparing Pandora's TSR for the period to the Russell 2000 Index TSR for the same period, using the average adjusted closing stock price of Pandora stock, and the Russell 2000 Index, for ninety calendar days prior to the beginning of the performance period and the last ninety calendar days of the performance period. In each period, the target number of shares will vest if the Pandora TSR is equal to the Russell 2000 Index TSR. For each percentage point that the Pandora TSR falls below the Russell 2000 Index TSR for the period, the performance multiplier is decreased by three percentage points. The performance multiplier is capped at 100% for the One-Year and Two-Year Performance Periods. However, the full award is eligible for a payout up to 200% of target, less any shares earned in prior periods, in the Three-Year Performance Period. Specifically, for each percentage point that the Pandora TSR exceeds the Russell 2000 Index TSR for the Three-Year Performance Period, the performance multiplier is increased by 2%. As such, the ability to exceed the target number of shares is determined exclusively with respect to Pandora's three-year TSR during the term of the award.

We have determined the grant-date fair value of the MSUs using a Monte Carlo simulation performed by a third-party valuation firm. We recognize stock-based compensation for the MSUs over the requisite service period, which is approximately three years, using the accelerated attribution method.

During the six months ended June 30, 2015 we granted 776,000 MSUs at a total grant-date fair value of \$4.3 million. There were no MSUs granted in the three or six months ended June 30, 2016. During the three months ended June 30, 2015 and 2016, we recorded stock-based compensation expense from MSUs of approximately \$0.5 million and \$0.2 million. During the six months ended June 30, 2015 and 2016, we recorded stock-based compensation expense from MSUs of approximately \$0.6 million and \$0.4 million.

In February 2016, the compensation committee of the board of directors certified the results of the One-Year Performance Period of the 2015 MSU grant, which concluded December 31, 2015. During the One-Year Performance Period, our relative TSR declined 26 percentage points relative to the Russell 2000 Index TSR for the period, which

resulted in the vesting of the One-Year Performance Period at 22% of the one-third vesting opportunity for the period.

PSUs

In April 2016, the compensation committee of the board of directors granted 2016 Performance Awards consisting of stock-settled performance-based RSUs to certain key executives under our 2011 Plan.

PSUs granted in April 2016 have a vesting period that includes a four year service period, during which one fourth of the awards will vest after one year and the remainder will vest quarterly thereafter. The PSUs are earned when our trailing average ninety-day stock price is equal to or greater than \$20.00. If the trailing average ninety-day stock price does not equal or exceed \$20.00 on the applicable vesting date, then the portion of the award that was scheduled to vest on such vesting date shall not

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

vest but shall vest on the next vesting date on which the trailing average ninety-day stock price equals or exceeds \$20.00. Any portion of the award that remains unvested as of the final vesting date shall be canceled and forfeited.

We have determined the grant-date fair value of the PSUs granted in April 2016 using a Monte Carlo simulation performed by a third-party valuation firm. We recognize stock-based compensation for the PSUs over the requisite service period, which is approximately four years, using the accelerated attribution method.

During the three and six months ended June 30, 2016 we granted 1,725,000 PSUs at a total grant-date fair value of \$8.7 million. There were no PSUs granted in the three or six months ended June 30, 2015. During the three and six months ended June 30, 2016, we recorded stock-based compensation expense from PSUs of approximately \$1.1 million. There was no stock-based compensation expense from PSUs in the three or six months ended June 30, 2015.

Stock-based Compensation Expense

Stock-based compensation expense related to all employee and non-employee stock-based awards was as follows:

	Three months ended June 30, 2015		Six months ended June 30, 2016	
	(in thousands)		(in thousands)	
Stock-based compensation expense				
Cost of revenue - Other	\$1,406	\$1,544	\$2,613	\$3,021
Cost of revenue - Ticketing service	—	67	—	127
Product development	5,354	7,243	9,959	15,744
Sales and marketing	13,327	15,128	24,671	28,741
General and administrative	7,397	8,450	13,436	23,454
Total stock-based compensation expense	\$27,484	\$32,432	\$50,679	\$71,087

In the six months ended June 30, 2016, we recorded stock-based compensation expense of \$6.8 million related to accelerated awards in connection with executive severance. This amount is included in the general and administrative line item of our condensed consolidated statements of operations.

9. Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period.

Diluted net loss per share is computed by giving effect to all potential shares of common stock, including stock options, restricted stock units, market stock units and performance-based RSUs, to the extent dilutive. Basic and diluted net loss per share were the same for the three and six months ended June 30, 2015 and 2016, as the inclusion of all potential common shares outstanding would have been anti-dilutive.

Table of Contents**Pandora Media, Inc.****Notes to Condensed Consolidated Financial Statements - Continued****(unaudited)**

The following table sets forth the computation of historical basic and diluted net loss per share:

	Three months ended June 30,		Six months ended June 30,	
	2015	2016	2015	2016
	(in thousands except per share amounts)		(in thousands except per share amounts)	
Numerator				
Net loss	\$ (16,065)	\$ (76,333)	\$ (64,322)	\$ (191,435)
Denominator				
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	211,742	229,745	210,840	228,202
Net loss per share, basic and diluted	\$ (0.08)	\$ (0.33)	\$ (0.31)	\$ (0.84)

The following potential common shares outstanding were excluded from the computation of diluted net loss per share because including them would have been anti-dilutive:

	As of June 30,	
	2015	2016
	(in thousands)	
Options to purchase common stock	10,478	10,027
Restricted stock units	16,189	23,906
Performance awards*	776	2,416
Total common stock equivalents	27,443	36,349

*Includes potential common shares outstanding for MSUs and PSUs

On December 9, 2015, we completed an offering of our 1.75% convertible senior notes due 2020. Under the treasury stock method, the Notes will generally have a dilutive impact on earnings per share if our average stock price for the period exceeds approximately \$16.42 per share of our common stock, the conversion price of the Notes. For the period from the issuance of the offering of the Notes through June 30, 2016, the conversion feature of the Notes was anti-dilutive.

In connection with the pricing of the Notes, we entered into capped call transactions which increase the effective conversion price of the Notes, and are designed to reduce potential dilution upon conversion of the Notes. Since the beneficial impact of the capped call is anti-dilutive, it is excluded from the calculation of earnings per share. Refer to Note 7 "Debt Instruments" for further details regarding our Notes.

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”)

You should read the following discussion of our financial condition and results of operations in conjunction with the condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

This Quarterly Report on Form 10-Q contains “forward-looking statements” that involve substantial risks and uncertainties. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Exchange Act, including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses, plans and objectives of management and economic, competitive and technological trends. In some cases, you can identify forward-looking statements by terms such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “project,” “will,” “would,” “should,” “could,” “can,” “predict,” “potential,” “continue,” “objective,” or the negative of these terms, and similar expressions intended 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 involve known 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. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled “Risk Factors” included in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2015. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements. We qualify all of our forward-looking statements by these cautionary statements. These and other factors could cause our results to differ materially from those expressed in this Quarterly Report on Form 10-Q.

Some of the industry and market data contained in this Quarterly Report on Form 10-Q are based on independent industry publications, including those generated by Triton Digital Media (“Triton”) 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, we have not independently verified the accuracy or completeness of this information.

As used herein, “Pandora,” the “Company,” “we,” “our,” and similar terms refer to Pandora Media, Inc., unless the context indicates otherwise.

“Pandora” and other trademarks of ours appearing in this report are our property. This report may contain additional trade names and trademarks of other companies. We do not intend our use or display of other companies’ trade names or trademarks to imply an endorsement or sponsorship of us by such companies, or any relationship with any of these companies.

Overview

Pandora - Internet Radio Service

Pandora is the world’s most powerful music discovery platform, offering a personalized experience for each of our listeners wherever and whenever they want to listen to music—whether through earbuds, car speakers or live on stage. Our vision is to be the definitive source of music discovery and enjoyment for billions. The majority of our listener

hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We offer both local and national advertisers the opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. Founded by musicians, Pandora also empowers artists with valuable data and tools to help grow their careers and connect with their fans.

For the three months ended June 30, 2016, we streamed 5.66 billion hours of radio, and as of June 30, 2016, we had 78.1 million active users during the prior 30-day period. Since we launched our non-subscription, ad-supported radio service in 2005 our listeners have created over 10 billion stations.

At the heart of our service is our set of proprietary personalization technologies, including the Music Genome Project and our playlist generating algorithms. The Music Genome Project is a database of over 1,000,000 uniquely analyzed songs from over 150,000 artists, spanning over 600 genres and sub-genres, which we develop one song at a time by evaluating and cataloging each song's particular attributes. When a listener enters a single song, artist, comedian or genre to start a station, the Pandora service instantly generates a station that plays music or comedy we think that listener will enjoy. Based on listener

Table of Contents

reactions to the recordings we pick, we further tailor the station to match the listener's preferences. Listeners also have the ability to add variety to and rename stations, which further allows for the personalization of our service.

We currently provide the Pandora service through two models:

- *Free Service.* Our free service is advertising-supported and allows listeners access to our music and comedy catalogs and personalized playlist generating system for free across all of our delivery platforms.

Pandora One. Pandora One is a premium daily, monthly or annual paid version of the Pandora service, which currently includes advertisement-free access. Pandora One also enables listeners to have more daily skips, enjoy higher quality audio on supported devices and enjoy longer timeout-free listening.

A key element of our strategy is to make the Pandora service available everywhere that there is internet connectivity. To this end, we make the Pandora service available through a variety of distribution channels. In addition to streaming our service to computers, we have developed Pandora mobile device applications (“apps”) for smartphones and mobile operating systems, such as the iPhone, Android and the Windows Phone and for tablets including the iPad and Android tablets. We distribute those mobile apps free to listeners via app stores. In addition to smartphones and tablets, Pandora is now integrated with more than 1,800 connected devices, including automobiles, automotive aftermarket devices and consumer electronic devices.

Ticketing Service

Ticketfly is a leading live events technology company that provides ticketing and marketing software and services for venues and event promoters across North America. Ticketfly's ticketing, digital marketing and analytics software helps promoters book talent, sell tickets and drive in-venue revenue, while Ticketfly's consumer tools help fans find and purchase tickets to events. Tickets are primarily sold through the Ticketfly platform but are also sold through other channels such as box offices. In the three months ended June 30, 2016, Ticketfly had approximately 38 thousand live events on sale, for which approximately 3.7 million tickets, excluding box office sales, were sold to approximately 1.6 million unique ticket buyers, which resulted in more than \$160 million in gross transaction value, excluding box office sales. We completed the acquisition of Ticketfly on October 31, 2015.

Factors Affecting our Business Model

Internet Radio Service

A majority of the listener hours for our internet radio service, our core business, occur on mobile devices and as such, we face challenges in optimizing our advertising products for delivery on mobile and other connected device platforms and monetizing inventory, or opportunities to sell advertisements, generated by listeners using these platforms.

In addition, our monetization strategy includes increasing the number of ad campaigns sold to local advertisers, placing us in more direct competition with broadcast radio for advertiser spending, especially for audio advertisements. Key to the success of our strategy to increase local advertising is our ability to convince a substantial base of local advertisers of the benefits of advertising on the Pandora service, including demonstrating the effectiveness and relevance of our advertising products, in particular audio advertising products.

Our total number of listener hours is a key driver for both revenue generation opportunities and content acquisition costs, which are the largest component of our 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.

Cost of Revenue—Content Acquisition Costs. We pay content acquisition costs, or royalties, to the copyright owners and performers, or their agents, of each sound recording that we stream, as well as to the publishers and songwriters, or their agents, for the musical works embodied in each of those sound recordings, subject to certain exclusions. Content acquisition costs are calculated based on the number of sound recordings streamed, revenue earned or other usage measures. The number of sound recordings we transmit to users of the Pandora service, as generally reflected by listener hours, drives a substantial majority of our content acquisition costs, although certain of our licensing agreements require us to pay fees for public performances of musical works based on a percentage of revenue.

Table of Contents

Royalties for sound recordings are negotiated with and paid to record labels, rights organizations or to SoundExchange, Inc. ("SoundExchange") and Merlin Networks B.V. ("Merlin"). During 2015, we paid performance rates for the sound recordings we streamed according to the terms of the Pureplay Settlement agreement (the "2015 Pureplay Rates"). On December 16, 2015, the Copyright Royalty Board ("CRB") announced new per-performance rates that apply for commercial webcasters for calendar years 2016 through 2020 (the "Web IV Rates"). Unlike the royalty structure applicable under the Pureplay Settlement agreement, the Web IV Rates do not include an alternative calculation based on percentage of revenue, but instead are solely based on per-performance rates. The rates for non-subscription services were set at \$0.0017 per play, and represent an approximate 21% increase from the 2015 Pureplay Rate for non-subscription services. The rates for subscription services were set at \$0.0022 per play and represent a 12% decrease from the 2015 Pureplay Rate for subscription services. The Web IV Rates took effect January 1, 2016 and the rates for the calendar years 2017 through 2020 will be adjusted by the CRB to reflect the increases or decreases, if any, in the Consumer Price Index, applicable to that rate year, but will otherwise be the same as the rates for calendar year 2016.

Royalties for musical works are most often negotiated with and paid to performing rights organizations ("PROs") such as ASCAP, BMI, SESAC and Global Music Rights ("GMR") or directly to publishing companies. During the twelve months ended December 31, 2015, we entered into several direct deals with ASCAP, BMI and music publishers. The majority of the licenses are structured so that each publisher or PRO receives a pro rata share of a royalty pool equal to 20% of the royalties paid by us for sound recordings, with the pro rata share of the pool paid to each publisher or PRO being determined based on our usage of its works. These license agreements are structured differently from previous PRO and publisher licenses, which have traditionally been based on a percentage of a service's revenue or a flat fee.

Given the per-play royalty structure of the Web IV Rates, our content acquisition costs increase with each additional listener hour, regardless of whether we are able to generate more revenue. As such, our ability to achieve and sustain profitability and operating leverage on our advertising-supported service depends on our ability to increase our revenue per hour of streaming through increased advertising revenue across all of our delivery platforms. Please refer to our discussion of these matters in "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015 for further information.

Other Offerings

In 2016, we have substantially increased our investments in our operations to drive anticipated future growth. One of our key objectives is to maintain our position as the most powerful music discovery platform, which we believe will strengthen our brand and help us to convince advertisers to allocate spending towards our ad products. As such, a central focus is adding, retaining and engaging listeners to build market share and grow our listener hours. As our business has matured, our revenue growth has exceeded the growth in our listener hours. However, we expect to incur increasing annual net losses in the near term because our current strategy is to leverage improvements in gross profit by investing in broadening distribution channels and developing innovative and scalable products.

In 2016 and 2017, we intend to launch new subscription offerings that provide additional functionality, including an on-demand music streaming service. The development and launch of such additional service offerings will require significant engineering effort, as well as marketing, and other resources. In order to successfully launch such additional service offerings, we will need to obtain the associated content licensing rights and we will need to attract listeners to these new service offerings. The market for subscription-based music services, including on-demand services, is intensely competitive, and our ability to realize a return on this investment will depend on our ability to leverage brand awareness and deliver a differentiated service that listeners find attractive.

We also intend to leverage the core Pandora internet radio service to expand our ticketing service. Our ticketing service consists of the Ticketfly platform, which is a fully-integrated cloud ticketing platform for live events. Ticketfly's platform provides ticketing and marketing services for venues and event promoters across North America and makes it easy for fans to find and purchase tickets to events, and also gives artists a means to more effectively promote their events.

Please refer to our discussion of these matters in “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015 for further information.

Key Metrics

The below key metrics do not include amounts related to our ticketing service, unless otherwise specifically stated.

Table of Contents*Listener Hours*

We track listener hours because it is a key indicator of the growth of our business. Beginning with the listener hours disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, we include listener hours related to our non-radio content offerings in the definition of listener hours. These offerings include non-music content such as podcasts, as well as custom music content such as Pandora Premiers and artist mixtapes. Historically, listener hours related to non-radio content represented a negligible number of listener hours. Including non-radio content in the listener hours we have previously reported for the three and six months ended June 30, 2015 would not have changed the reported listener hours. We calculate listener hours based on the total bytes served for each track that is requested and served from our servers, as measured by our internal analytics systems, whether or not a listener listens to the entire track. For non-music content such as podcasts, episodes are divided into approximately track-length parts, which are treated as tracks under this definition. To the extent that third-party measurements of listener hours are not calculated using a similar server-based approach, the third-party measurements may differ from our measurements.

The table below sets forth our total listener hours for the three and six months ended June 30, 2015 and 2016.

	Three months ended June 30, 2015	Six months ended June 30, 2016
Listener hours	5.305.66	10.6011.18

Active Users

We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time. We define active users as the number of distinct registered users, including subscribers, 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. Beginning with the active users disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, we are also including active users who only request non-radio content offerings in the definition of active users. Including users who only request non-radio content in the calculation of active users would not have materially changed the reported active users as of June 30, 2015.

The table below sets forth our total active users as of June 30, 2015 and 2016.

	As of June 30, 2015	2016
Active users	79.4	78.1

We define advertising-based active users (“ad-based active users”) as the number of users, excluding subscribers, that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. We define subscribers as the number of distinct users at the end of the period that have subscribed to our service. Inactive subscribers are included as they contribute towards revenue per thousand listener hours (“RPMs”), which are described in further detail below.

The table below sets forth our users on an advertising and subscription basis as of June 30, 2015 and 2016.

Table of Contents

	As of	
	June 30,	
	2015	2016
User type	Users (in millions)	
Ad-based active users	76.0	74.7
Subscribers*	3.9	3.9
Total	79.9	78.6

* Includes subscribers that have not used our service within the trailing 30 days to the end of the final calendar month of the period.

The table below sets forth our listener hours on an advertising and subscription basis for the three and six months ended June 30, 2015 and 2016.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2015	2016	2015	2016
User type	Listener hours (in billions)		Listener hours (in billions)	
Ad-based active users	4.63	4.97	9.30	9.82
Subscribers	0.67	0.69	1.30	1.36
Total	5.30	5.66	10.60	11.18

Advertising Revenue per Thousand Listener Hours (“ad RPMs”)

We track ad RPMs for our non-subscription, ad-supported service because it is a key indicator of our ability to monetize advertising inventory created by our listener hours. We believe ad RPMs to be the central top-line indicator for evaluating the results of our monetization efforts. Ad RPMs are calculated by dividing advertising revenue by the number of thousands of listener hours of our advertising-based service.

Subscription and Other Revenue per Thousand Listener Hours (“subscription RPMs”)

We track subscription RPMs because it is a key indicator of the performance of our subscription service. Subscription RPMs are calculated by dividing subscription and other revenue by the number of thousands of listener hours of our subscription service.

Total Revenue per Thousand Listener Hours (“total RPMs”)

We track total RPMs for our service, which includes ad and subscription RPMs, because it is a key indicator of our ability to monetize our listener hours. Total RPMs compare advertising and subscription and other revenue in a given period to total listener hours in the period. We calculate total RPMs by dividing the total revenue by the number of thousands of listener hours.

Licensing Costs per Thousand Listener Hours (“LPMs”)

We track LPMs and analyze them in combination with our analysis of RPMs as they provide a key indicator of our profitability. LPMs are relatively fixed licensing costs with scheduled annual rate adjustments that drive

period-over-period changes in LPMs. As such, the margin on our business varies principally with variances in ad RPMs and subscription RPMs.

Historically, we provided estimates of disaggregated ad RPMs, subscription RPMs, total RPMs and related LPMs for our computer platform as well as our mobile and other connected devices platforms. Starting in the three months ended March 31, 2016, we no longer present disaggregated RPMs or LPMs for our computer or mobile and other connected devices platforms. Previously, we had provided this information in order to demonstrate the potential monetization expansion opportunity as mobile and other connected devices markets matured. Revenue and listener hours for mobile and other connected devices have since grown to represent the significant majority of our total revenue and listener hours. In addition, we currently manage the business to optimize revenue across our device platforms and thus we no longer assess our performance on a disaggregated basis. As such, we no longer believe this disaggregation is relevant.

Table of Contents

Period-to-period results should not be regarded as precise nor can they be relied upon as indicative of results for future periods. In addition, as our business matures and in response to technological evolutions, we anticipate that the relevant indicators we monitor for evaluating our business may change.

The table below sets forth our RPMs and LPMs on an ad, subscription and total basis for the three months ended June 30, 2015 and 2016.

**Three months ended June
30,
2015 2016
RPM LPM* RPM LPM***

Advertising	\$49.94	\$22.54	\$53.34	\$30.65
Subscription	81.15	38.49	79.79	35.30
Total	\$53.91	\$24.57	\$56.56	\$31.21

*We pay per-performance rates for the streaming of sound recordings for our Pandora One subscription service that are higher than the per-performance rates for our advertising-supported service.

The table below sets forth our RPMs and LPMs on an ad, subscription and total basis for the six months ended June 30, 2015 and 2016.

**Six months ended June 30,
2015 2016
RPM LPM* RPM LPM***

Advertising	\$44.09	\$22.13	\$49.46	\$30.56
Subscription	81.60	38.68	80.62	35.24
Total	\$48.72	\$24.17	\$53.25	\$31.13

*We pay per-performance rates for the streaming of sound recordings for our Pandora One subscription service that are higher than the per-performance rates for our advertising-supported service.

Advertising RPMs

For the three and six months ended June 30, 2016 compared to 2015, the increase in advertising RPMs was primarily due to the growth in advertising revenue outpacing the growth in advertising listener hours as a result of an increase in the average price per ad.

Subscription RPMs

For the three and six months ended June 30, 2016 compared to 2015, the decrease in subscription RPMs was due to the growth in subscription listening hours outpacing the growth in subscription revenue.

Advertising LPMs

For the three and six months ended June 30, 2016 compared to 2015, advertising LPMs increased as a result of royalty rate increases of 21% on our advertising-supported platform and increases in content acquisition costs paid to PROs and publishers due to the royalty structure of our new publishing licenses.

Subscription LPMs

For the three and six months ended June 30, 2016 compared to 2015, subscription LPMs decreased as a result of royalty rate decreases of 12% on our subscription-supported platform, offset by increases in content acquisition costs

paid to PROs and publishers under the royalty structure of our new publishing licenses.

Basis of Presentation and Results of Operations

27

Table of Contents

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

	Three months ended June 30, 2015		Six months ended June 30, 2016	
Revenue				
Advertising	81	% 77 %	79	% 76 %
Subscription and other	19	16	21	17
Ticketing service	—	7	—	7
Total revenue	100	100	100	100
Cost of revenue				
Cost of revenue — Content acquisition costs	46	51	50	54
Cost of revenue — Other (1)	7	7	7	7
Cost of revenue — Ticketing service (1)	—	4	—	5
Total cost of revenue	53	63	57	66
Gross profit	47	37	43	34
Operating expenses				
Product development (1)	7	10	7	11
Sales and marketing (1)	33	36	35	38
General and administrative (1)	14	12	15	14
Total operating expenses	53	58	56	62
Loss from operations	(6)	(21)	(13)	(28)
Interest expense	—	(2)	—	(2)
Other income, net	—	—	—	—
Total other expense, net	—	(2)	—	(2)
Loss before provision for income taxes	(6)	(23)	(12)	(30)
Provision for income taxes	—	—	—	—
Net loss	(6)	(22)%	(12)%	(30)%

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	0.5%	0.5%	0.5%	0.5%
Cost of revenue - Ticketing service	—	—	—	—
Product development	1.9	2.1	1.9	2.5
Sales and marketing	4.7	4.4	4.8	4.5
General and administrative	2.6	2.5	2.6	3.7

Note: Amounts may not recalculate due to rounding

Table of Contents*Revenue*

	Three months ended June 30,			Six months ended June 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
Revenue						
Advertising	\$ 230,921	\$ 265,126	\$ 34,205	\$ 409,660	\$ 485,434	\$ 75,774
Subscription and other	54,639	55,125	486	106,664	109,857	3,193
Ticketing service	—	22,771	22,771	—	45,036	45,036
Total revenue	\$ 285,560	\$ 343,022	\$ 57,462	\$ 516,324	\$ 640,327	\$ 124,003

Advertising revenue

We generate advertising revenue primarily from audio, display and video advertising, which is typically sold on a cost-per-thousand impressions, or CPM, basis. Advertising campaigns typically range from one to twelve months, and advertisers generally pay us based on the number of delivered impressions or the satisfaction of other criteria, such as click-throughs. We also have arrangements with advertising agencies under which these agencies sell advertising inventory on our service directly to advertisers. We report revenue under these arrangements net of amounts due to agencies. For the three months ended June 30, 2015 and 2016 and the six months ended June 30, 2015 and 2016, advertising revenue accounted for 81%, 77%, 79% and 76%, of our total revenue, respectively. We expect that advertising will comprise a substantial majority of our revenue for the foreseeable future.

For the three months ended June 30, 2016 compared to 2015, advertising revenue increased \$34.2 million or 15%, primarily due to an approximate 20% increase in the average price per ad due in part to our increase in relative volume of local ad sales and our focus on monetizing mobile inventory.

For the six months ended June 30, 2016 compared to 2015, advertising revenue increased \$75.8 million or 18%, primarily due to an approximate 30% increase in the average price per ad due in part to our increase in relative volume of local ad sales and our focus on monetizing mobile inventory.

Subscription and other revenue

Subscription and other revenue is generated primarily through the sale of Pandora One, a premium version of the Pandora service, which currently includes advertisement-free access and higher audio quality on the devices that support it. Subscription revenue is recognized on a straight-line basis over the duration of the subscription period. For the three months ended June 30, 2015 and 2016 and the six months ended June 30, 2015 and 2016, subscription and other revenue accounted for 19%, 16%, 21% and 17% of our total revenue, respectively.

For the three months ended June 30, 2016 compared to 2015, subscription revenue increased \$0.5 million or 1%, primarily due to a 1% increase in the number of subscribers.

For the six months ended June 30, 2016 compared to 2015, subscription revenue increased \$3.2 million or 3%, primarily due to an approximate 2% increase in the average price per subscription and a 1% increase in the number of subscribers.

Ticketing service

Ticketing service revenue is generated primarily from service and merchant processing fees generated on ticket sales through the Ticketfly platform. Ticketfly sells tickets to fans for events on behalf of clients and charges a fee per ticket, which generally increases as the face value of the ticket increases, or a percentage of the total convenience charge and order processing fee, for its services at the time the ticket for an event is sold. Ticketing service revenue is recorded net of the face value of the ticket at the time of the sale, as Ticketfly generally acts as the agent in these transactions.

For the three and six months ended June 30, 2016, ticketing service revenue was \$22.8 million and \$45.0 million and accounted for approximately 7% of our total revenue. In the three months ended June 30, 2016, Ticketfly had approximately 38 thousand live events on sale, for which approximately 3.7 million tickets, excluding box office sales, were sold to approximately 1.6 million unique ticket buyers, which resulted in more than \$160 million in gross transaction value, excluding box office sales. In the six months ended June 30, 2016, Ticketfly had approximately 74 thousand live events on sale, for which

Table of Contents

approximately 7.5 million tickets, excluding box office sales, were sold to approximately 3.2 million unique ticket buyers, which resulted in more than \$330 million in gross transaction value, excluding box office sales. We had no ticketing service revenue in the three and six months ended June 30, 2015, given that the acquisition of Ticketfly was completed on October 31, 2015.

Deferred revenue

Our deferred revenue consists principally of both prepaid but unrecognized subscription revenue and advertising fees received or billed in advance of the delivery or completion of the delivery of services. Deferred revenue is recognized as revenue when the services are provided and all other revenue recognition criteria have been met.

In addition, subscription revenue derived from sales through certain mobile devices may be subject to refund or cancellation terms which may affect the timing or amount of the subscription revenue recognition. When refund rights exist, we recognize revenue when services have been provided and the rights lapse or when we have developed sufficient transaction history to estimate a return reserve.

Costs and Expenses

Cost of revenue consists of cost of revenue—content acquisition costs, cost of revenue—other and cost of revenue—ticketing. Our operating expenses consist of product development, sales and marketing and general and administrative costs. Cost of revenue—content acquisition costs are the most significant component of our costs and expenses, followed by employee-related costs, which include stock-based compensation expenses. We expect to continue to hire additional employees in order to support our anticipated growth and our product development initiatives. In any particular period, the timing of additional hires could materially affect our cost of revenue and 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—Content acquisition costs

	Three months ended June 30,			Six months ended June 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
Cost of revenue - Content acquisition costs	\$ 130,134	\$ 176,633	\$ 46,499	\$ 256,157	\$ 347,897	\$ 91,740

Cost of revenue—content acquisition costs principally consist of royalties paid for streaming music or other content to our listeners. Royalties are currently calculated using negotiated rates documented in agreements. The majority of our royalties are payable based on a fee per public performance of a sound recording, while in other cases our royalties are payable based on a percentage of our revenue, a formula that involves a combination of per performance and revenue metrics or a percentage of royalties paid for sound recordings. For certain royalty arrangements, we accrue for estimated royalties based on the available facts and circumstances and adjust these estimates as more information becomes available.

For the three months ended June 30, 2016 compared to 2015, content acquisition costs increased \$46.5 million or 36% and content acquisition costs as a percentage of total revenue increased from 46% to 51%, primarily due to blended sound recording royalty rate increases of 15%, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs due to the royalty structure of our new publishing licenses.

For the six months ended June 30, 2016 compared to 2015, content acquisition costs increased \$91.7 million or 36% and content acquisition costs as a percentage of total revenue increased from 50% to 54%, primarily due to blended sound recording royalty rate increases of 15%, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs due to the royalty structure of our new publishing licenses.

Cost of revenue—Other

30

Table of Contents

	Three months ended June 30, 2016			Six months ended June 30, 2016		
	2015	2016	\$ Change	2015	2016	\$ Change
Cost of revenue — Other	\$20,043	\$24,833	\$ 4,790	\$36,276	\$45,832	\$ 9,556

Cost of revenue—other consists primarily of ad and music serving costs, employee-related and facilities and equipment costs and other costs of ad sales. Ad and music serving costs consist of content streaming, maintaining our internet radio service and creating and serving advertisements through third-party ad servers. We make payments to third-party ad servers for the period the advertising impressions are delivered or click-through actions occur, and accordingly, we record this as a cost of revenue in the related period. Employee-related costs include salaries and benefits associated with supporting music and ad serving functions. Other costs of ad sales include costs related to music events that are sold as part of advertising arrangements.

For the three months ended June 30, 2016 compared to 2015, cost of revenue—other increased \$4.8 million or 24%, primarily due to a \$3.7 million increase in hosting and ad serving costs driven by an increase in advertising revenue and a \$2.4 million increase in employee-related and facilities and equipment costs driven by an approximate 25% increase in headcount, offset by a decrease of \$1.5 million in costs related to music events that are sold as part of advertising arrangements.

For the six months ended June 30, 2016 compared to 2015, cost of revenue—other increased \$9.6 million or 26%, primarily due to a \$5.9 million increase in employee-related and facilities and equipment costs driven by an approximate 25% increase in headcount and a \$5.6 million increase in hosting and ad serving costs driven by an increase in advertising revenue, offset by a decrease of \$2.1 million in costs related to music events that are sold as part of advertising arrangements.

Cost of revenue - Ticketing service

	Three months ended June 30, 2016		Six months ended June 30, 2016	
	2015	\$ Change	2015	\$ Change
Cost of revenue — Ticketing service	\$—	\$ 15,259	\$—	\$ 29,905

Cost of revenue—ticketing service consists primarily of ticketing revenue share costs, credit card fees and other cost of revenue and intangible amortization expense. The majority of these costs are related to revenue share costs, which consist of fees paid to clients for their share of convenience and order processing fees. Intangible amortization expense is related to amortization of developed technology acquired in connection with the Ticketfly acquisition.

For the three months ended June 30, 2016, cost of revenue—ticketing service was \$15.3 million and consisted primarily of \$10.0 million in ticketing revenue share costs, \$3.4 million in credit card fees and other cost of revenue and \$1.4 million in intangible amortization expense. We had no cost of revenue—ticketing service in the three months ended June 30, 2015, given that the acquisition of Ticketfly was completed on October 31, 2015.

For the six months ended June 30, 2016, cost of revenue—ticketing service was \$29.9 million and consisted primarily of \$20.2 million in ticketing revenue share costs, \$6.3 million in credit card fees and other cost of revenue and \$2.8 million in intangible amortization expense. We had no cost of revenue—ticketing service in the six months ended

June 30, 2015, given that the acquisition of Ticketfly was completed on October 31, 2015.

Gross profit

31

Table of Contents

	Three months ended June 30,			Six months ended June 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
Gross profit						
Total revenue	\$285,560	\$343,022	\$57,462	\$516,324	\$640,327	\$124,003
Total cost of revenue	150,177	216,725	66,548	292,433	423,634	131,201
Gross profit	\$135,383	\$126,297	\$(9,086)	\$223,891	\$216,693	\$(7,198)
Gross margin	47	% 37	%	43	% 34	%

For the three months ended June 30, 2016 compared to 2015, gross profit decreased by \$9.1 million or 7% and gross margin decreased from 47% to 37% as the growth in content acquisition costs outpaced the growth in revenue, primarily due to blended royalty rate increases of 15%, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs under the royalty structure of our new publishing licenses.

For the six months ended June 30, 2016 compared to 2015, gross profit decreased by \$7.2 million or 3% and gross margin decreased from 43% to 34% as the growth in content acquisition costs outpaced the growth in revenue, primarily due to blended royalty rate increases of 15%, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs under the royalty structure of our new publishing licenses.

Product development

	Three months ended June 30,			Six months ended June 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
Product development	\$18,742	\$33,808	\$15,066	\$34,617	\$69,654	\$35,037

Product development consists primarily of employee-related and facilities and equipment costs, including salaries and benefits related to employees in software engineering, music analysis and product management departments, information technology, costs associated with supporting consumer connected-device manufacturers in implementing our service in their products and amortization expense related to acquired intangible assets. 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 station generating system. We have generally expensed product development as incurred. These amounts are offset by costs that we capitalize to develop software for internal use. Certain website development and internal use software development costs are capitalized when specific criteria are met. In such cases, the capitalized amounts are amortized over the useful life of the related application once the application is placed in service. We expect these capitalized costs to increase during the remainder of 2016 as we develop an on-demand streaming service. We intend to substantially increase investments in developing new products and enhancing the functionality of our existing products.

For the three months ended June 30, 2016 compared to 2015, product development expense increased by \$15.1 million or 80%, primarily due to a \$17.9 million increase in employee-related and facilities and equipment costs driven by an approximate 90% increase in headcount, a \$1.8 million increase in intangible amortization expense and an increase of \$1.1 million in professional fees, offset by a \$5.8 million increase in costs that we capitalized to develop software for internal use.

For the six months ended June 30, 2016 compared to 2015, product development expenses increased \$35.0 million or 101%, primarily due to a \$40.3 million increase in employee-related and facilities and equipment costs driven by an

approximate 90% increase in headcount, a \$3.6 million increase in intangible amortization expense and an increase of \$2.3 million in professional fees, offset by an \$11.2 million increase in costs that we capitalized to develop software for internal use.

Sales and marketing

32

Table of Contents

	Three months ended June 30,			Six months ended June 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
Sales and marketing	\$94,035	\$123,812	\$29,777	\$178,309	\$241,434	\$63,125

Sales and marketing consists primarily of employee-related and facilities and equipment costs, including salaries, commissions and benefits related to employees in sales, sales support, marketing, advertising and music maker group departments. In addition, sales and marketing expenses include transaction processing commissions on subscription purchases through mobile app stores, external sales and marketing expenses such as brand marketing, advertising, direct response and search engine marketing costs, public relations expenses, costs related to music events, agency platform and media measurement expenses, infrastructure costs and amortization expense related to acquired intangible assets.

We are substantially increasing sales and marketing expenses to drive growth as we hire additional personnel to build out our sales and sales support teams, particularly as we continue to build out our local market sales team. In 2015, we launched advertising campaigns to increase the awareness of our brand. We anticipate that we will continue to utilize these types of advertising campaigns in the future. As such, we anticipate higher overall levels of sales and marketing expense going forward.

For the three months ended June 30, 2016 compared to 2015, sales and marketing expenses increased \$29.8 million or 32%, primarily due to a \$14.3 million increase in brand marketing, advertising, direct response and search engine marketing costs driven by our advertising campaigns launched in the three months ended June 30, 2016, a \$13.6 million increase in employee-related and facilities and equipment costs driven by an approximate 20% increase in headcount and a \$1.7 million increase in intangible amortization expense.

For the six months ended June 30, 2016 compared to 2015, sales and marketing expenses increased \$63.1 million or 35%, primarily due to a \$32.5 million increase in employee-related and facilities and equipment costs driven by an approximate 20% increase in headcount, a \$23.0 million increase in brand marketing, advertising, direct response and search engine marketing costs driven by our advertising campaigns launched in the six months ended June 30, 2016, a \$3.4 million increase in intangible amortization expense and a \$1.6 million increase in transaction processing commissions on subscription purchases through mobile app stores.

General and administrative

	Three months ended June 30,			Six months ended June 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
General and administrative	\$38,812	\$40,562	\$1,750	\$75,566	\$86,858	\$11,292

General and administrative consists primarily of employee-related and facilities and equipment costs, including salaries, benefits and severance expense for finance, accounting, legal, internal information technology and other administrative personnel. In addition, general and administrative expenses include professional services costs for outside legal and accounting services, infrastructure costs, credit card fees and sales and other tax expense. We expect general and administrative expenses to increase in future periods as we continue to invest in corporate infrastructure, including adding personnel and systems to our administrative functions.

Edgar Filing: Pandora Media, Inc. - Form 10-Q

For the three months ended June 30, 2016 compared to 2015, general and administrative expenses increased \$1.8 million or 5%, primarily due to an increase of \$6.3 million in employee-related and facilities and equipment costs driven by an approximate 30% increase in headcount and a \$0.8 million increase in sales and other tax expense, offset by a \$6.7 million decrease in professional fees related to royalty and other legal matters.

For the six months ended June 30, 2016 compared to 2015, general and administrative expenses increased \$11.3 million or 15%, primarily due to a \$22.0 million increase in employee-related and facilities and equipment costs driven by executive severance and an approximate 30% increase in headcount and a \$1.8 million increase in sales and other tax expense, offset by a \$14.0 million decrease in professional fees related to royalty and other legal matters.

Table of Contents

Interest expense

Interest expense in the three and six months ended June 30, 2016 consists of interest expense on our 1.75% Convertible Senior Notes due 2020. Refer to Note 7 “Debt Instruments” in the Notes to Consolidated Financial Statements for further details on our Notes.

Provision for (benefit from) income taxes

We have historically been subject to income taxes in the United States and various foreign jurisdictions. As we expand our operations to other foreign locations, we become subject to taxation based on the applicable foreign statutory rates and our effective tax rate could fluctuate accordingly.

Our provision for (benefit from) income taxes is 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.

As a result of acquisitions, deferred tax liabilities were established for the book-tax basis difference related to acquired intangible assets. The net deferred tax liabilities provided an additional source of income to support the realizability of pre-existing deferred tax assets. During the three months ended June 30, 2016, we made an adjustment to goodwill and deferred tax liabilities as a result of the impact of final pre-acquisition Ticketfly income tax returns filed. As a result, during the three and six months ended June 30, 2016, we released \$1.9 million of our valuation allowance and recorded an income tax benefit.

Off-Balance Sheet Arrangements

Our liquidity is not dependent on the use of off-balance sheet financing arrangements and as of June 30, 2016 we had no such arrangements.

Contractual Obligations

There has been no material change in our contractual obligations other than in the ordinary course of business since the year ended December 31, 2015.

Quarterly Trends

Our operating results fluctuate from quarter to quarter as a result of a variety of factors. We expect our operating results to continue to fluctuate in future quarters.

Pandora

Our results reflect the effects of seasonal trends in listener and advertising behavior. We expect to experience both higher advertising sales due to greater advertiser demand during the holiday season and increased usage due to the popularity of holiday music during the last three months of each calendar year. In addition, we expect to experience lower advertising sales in the first three months of each calendar year due to reduced advertiser demand and increased usage due to increased use of media-streaming devices received as gifts during the holiday season. We believe these seasonal trends have affected, and will continue to affect our operating results, particularly as increases in content acquisition costs from increased usage are not offset by increases in advertising sales in the first calendar quarter.

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.

Ticketing Service

Ticketfly's results reflect the effects of seasonality related to the timing of events. Tickets for festivals typically go on sale during the first half of the year. As such, the Ticketfly business has historically experienced an increase in revenue in the

Table of Contents

first half of each year relative to the fourth quarter of the prior year. We expect these seasonal trends to continue to affect our operating results.

Liquidity and Capital Resources

As of June 30, 2016, we had cash, cash equivalents and investments totaling \$311.3 million, which primarily consisted of cash and money market funds held at major financial institutions, commercial paper and investment-grade corporate debt securities.

Our principal uses of cash during the three and six months ended June 30, 2016 were funding our operations, 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 twelve 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

Credit Facility

We are party to a \$120.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. As of June 30, 2016, we had no borrowings outstanding, \$1.2 million in letters of credit outstanding and \$118.8 million of available borrowing capacity under the credit facility.

1.75% Convertible Senior Notes Due 2020

On December 9, 2015, we completed an unregistered Rule 144A offering of \$345.0 million aggregate principal amount of our 1.75% Convertible Senior Notes due 2020. The net proceeds from the sale of the Notes were approximately \$336.5 million, after deducting the initial purchaser's fees and other estimated expenses. We used approximately \$43.2 million of the net proceeds to pay the cost of the capped call transactions. Refer to Note 7 "Debt Instruments" in the Notes to Consolidated Financial Statements for further details on our Notes.

The Notes are unsecured, senior obligations of Pandora, and interest is payable semi-annually at a rate of 1.75% per annum. The Notes will mature on December 1, 2020, unless earlier repurchased or redeemed by Pandora or converted in accordance with their terms prior to such date. Prior to July 1, 2020, the Notes are convertible at the option of holders only upon the occurrence of specified events or during certain periods thereafter, until the second scheduled trading day prior to maturity, the Notes will be convertible at the option of holders at any time.

The conversion rate for the Notes is initially 60.9050 shares of common stock per \$1,000 principal amount of the Notes, which is equivalent to an initial conversion price of approximately \$16.42 per share of our common stock, and is subject to adjustment in certain circumstances.

The Notes were separated into debt and equity components and assigned a fair value. The value assigned to the debt component is the estimated fair value as of the issuance date of similar debt without the conversion feature. The difference between the cash proceeds and this estimated fair value represents the value which has been assigned to the equity component and recorded as a debt discount. The debt discount is being amortized using the effective interest method.

The capped call transactions are expected generally to reduce the potential dilution to our common stock and/or offset the cash payments we would be required to make in excess of the principal amount of the converted Notes in the event that the market price of our common stock, as measured under the terms of the capped call transaction, is greater than the strike price of the capped call transaction, with such reduction and/or offset subject to a cap based on the cap price of the capped call transactions. The strike price of the capped call transactions corresponds to the initial conversion price of the Notes and is subject to certain adjustments under the terms of the capped call transactions. The capped call transactions have an initial cap

Table of Contents

price of \$25.26 per share and are subject to certain adjustments under the terms of the capped call transactions. The capped call transactions have been included as a net reduction to additional paid-in capital within stockholders' equity.

Capital Expenditures

Consistent with previous periods, future capital expenditures will primarily focus on acquiring additional hosting and general corporate infrastructure. Our access to capital is adequate to meet our anticipated capital expenditures for our current plans.

Historical Trends

The following table summarizes our cash flow data for the six months ended June 30, 2015 and 2016.

	Six months ended June 30, 2015 2016 (in thousands)	
Net cash provided by (used in) operating activities	\$17,059	\$(58,578)
Net cash provided by (used in) investing activities	6,093	(40,384)
Net cash provided by financing activities	5,230	2,917

Operating activities

In the six months ended June 30, 2016, net cash used in operating activities was \$58.6 million and primarily consisted of our net loss of \$191.4 million, which was partially offset by non-cash charges of \$109.4 million, primarily related to \$71.1 million in stock-based compensation charges and \$27.6 million in depreciation and amortization expense. Net cash used in operating activities also included a decrease in accounts payable of \$17.4 million and an increase in prepaid expenses and other assets of \$16.1 million primarily related to advance payments made for the publishing agreements signed in 2015, offset by an increase in accrued royalties of \$26.2 million and a decrease of \$12.1 million in cash from collections of accounts receivables. Net cash used in operating activities increased by \$75.6 million from the six months ended June 30, 2015, primarily due to an increase in our net loss of \$127.1 million.

Investing activities

In the six months ended June 30, 2016, net cash used in investing activities was \$40.4 million and included \$34.6 million of capital expenditures for leasehold improvements and server equipment, \$14.3 million of capital expenditures for internal-use software and \$11.1 million in purchases of investments, offset by \$20.5 million in proceeds from sales and maturities of investments. Net cash used in investing activities increased by \$46.5 million from the six months ended June 30, 2015, primarily due to a decrease in proceeds from sales and maturities of investments of \$115.3 million, an increase in capital expenditures for leasehold improvements and server equipment of \$20.0 million and an increase in capital expenditures for internal-use software of \$10.9 million, offset by a decrease in purchases of investments of \$100.5 million.

Financing activities

In the six months ended June 30, 2016, net cash provided by financing activities was \$2.9 million and included \$3.8 million in proceeds from our employee stock purchase plan and \$1.9 million in proceeds from the exercise of stock options, offset by \$2.8 million in tax payments from net share settlements of RSUs. Net cash provided by financing activities decreased \$2.3 million from the six months ended June 30, 2015, primarily due to an increase in tax

payments from net share settlements of RSUs of \$1.9 million and a decrease in proceeds from the exercise of stock options of \$1.0 million.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates

Table of Contents

form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

There have been no material changes to our critical accounting policies and estimates as compared to those described in our Annual Report on Form 10-K for the year ended December 31, 2015 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates.”

Table of Contents

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Fluctuation Risk

There have been no material changes in our primary market risk exposures or how those exposures are managed from the information disclosed in Part II, Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2015. For further discussion of quantitative and qualitative disclosures about market risk, reference is made to our Annual Report on Form 10-K.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Based on their evaluation at the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2016.

Changes in Internal Control over Financial Reporting

There have been no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The material set forth in Note 5 in the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

Item 1A. 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 risk factors described in “Part I - Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015 and all information set forth in this Quarterly Report on Form 10-Q. Those risks and the risks described in this Quarterly Report on Form 10-Q, 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.

There have been no material changes to the Risk Factors described under “Part I - Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015.

Table of Contents

Item 5. Other Information

On April 21, 2016, the Board of Directors of the Company (the “Board”) conditionally approved an amendment to the Company’s Amended and Restated Bylaws (the “Bylaw Amendment”) to require all directors and officers of the Company to comply with all applicable requirements of the Communications Act of 1934, as amended, and the rules and policies of the Federal Communications Commission. The Board also authorized the officers of the Company to cause the Bylaw Amendment to become effective contingent upon the approval of the Charter Amendment by the Company’s stockholders at the 2016 annual meeting of stockholders.

As with the previously disclosed amendment to our Amended and Restated Certificate of Incorporation (the “Charter Amendment”), the Bylaw Amendment was conditionally approved in order to comply with the conditions imposed by the Federal Communications Commission in the Declaratory Ruling issued on May 1, 2015 in connection with our acquisition of the license to operate the FM radio station KXMZ.

The Company’s officers caused the Bylaw Amendment to be executed and effective July 21, 2016.

The foregoing summary of the Bylaw Amendment is not complete and is subject to, and qualified in its entirety by, the full text of the Bylaw Amendment, which is filed as Exhibit 3.04 hereto and incorporated by reference herein.

Table of Contents**Item 6. Exhibits**

Exhibit No.	Exhibit Description	Incorporated by Reference			Filed By	Filed Herewith
		Form	File No.	Exhibit		
3.01	Amended and Restated Certificate of Incorporation	S-1/A	333-172215	3.1	4/4/2011	
3.02	Certificate of Amendment to the Amended and Restated Certificate of Incorporation					X
3.03	Amended and Restated Bylaws	S-1/A	333-172215	3.2	4/4/2011	
3.04	Certificate of Amendment to the Amended and Restated Bylaws					X
10.01†	Form of Performance Award Agreement under the 2011 Equity Incentive Plan					X
31.01	Certification of the Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.02	Certification of the Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.01	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to 8 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101. INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document					X
101. SCH	XBRL Taxonomy Schema Linkbase Document					X
101.CAL	XBRL Taxonomy Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Labels Linkbase Document					X
101.PRE	XBRL Taxonomy Presentation Linkbase Document					X

† Indicates management contract or compensatory plan.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Pandora Media, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PANDORA MEDIA, INC.

Date: July 26, 2016 By: /s/ Michael S. Herring

Michael S. Herring

President and Chief Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)