

PUBLIC VERSION

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
THE LIBRARY OF CONGRESS
Washington, D.C.

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In re)	
)	
DETERMINATION OF ROYALTY)	Docket No. 14-CRB-0001-WR (2016-2020)
RATES AND TERMS FOR)	
EPHEMERAL RECORDING AND)	
DIGITAL PERFORMANCE OF)	
SOUND RECORDINGS (<i>WEB IV</i>))	
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WRITTEN DIRECT TESTIMONY OF MICHAEL HERRING

(On behalf of Pandora Media, Inc.)

Introduction

1. My name is Mike Herring. I am the Chief Financial Officer of Pandora Media, Inc. (“Pandora” or “the Company”). I report directly to Pandora’s CEO Brian McAndrews, and I am a member of the Company’s executive committee. I have served as CFO of Pandora since I joined the Company in February 2013. I am a Certified Public Accountant, and I graduated with a Bachelor of Arts in Economics and Political Science from UCLA in 1991.

2. Before joining Pandora in 2013, I served as Vice President of Operations at Adobe Systems Incorporated, the well-known computer software company. I joined Adobe in 2009 from Omniture Inc., a company specializing in website analytics and online marketing automation. Beginning in 2004, I was Omniture’s Executive Vice President and Chief Financial Officer. Before Omniture, I served as Chief Financial Officer of MyFamily.com (now Ancestry.com), having joined that company in October 2000. I came to MyFamily.com from ThirdAge Media, an Internet company where I served as Vice President, Finance, and before that Anergis Inc., a Silicon Valley biotech firm, where I served as Controller.

3. As Chief Financial Officer of Pandora, I oversee a staff of nearly 200 people who are responsible for all aspects of the Company's finances and accounting, including reporting to the Securities and Exchange Commission ("SEC") and investor relations. The following departments report to me: Business Solutions, Facilities, Finance, Internal Audit, IT Support, Legal, Tax & Treasury, and Technical Operations departments. I also play an active role in planning the general business strategy of Pandora. Most notably here, the Business Affairs function – which executes our content licensing strategies, including our relationships with music publishers, record companies, and recording artists – reports directly to me.

4. My testimony below addresses three main topics:

a) *The impact of sound recording royalties on Pandora's finances.* Pandora has suffered cumulative losses of more than [REDACTED] since 2005, and has yet to see its first profitable year. A significant contributing factor to those losses is Pandora's staggering sound recording performance royalties, which have totaled more than \$1 billion since the company launched in 2005. As I set out in my testimony below, those royalties have been generated, not under the statutory license fees set in the *Web II* and *Web III* CRB proceedings but, rather, pursuant to significantly lower rates negotiated under the auspices of the Webcaster Settlement Acts of 2008 and 2009. The stark reality is that if Pandora had paid at the higher *Web II* and *Web III* rates, without anything else changing, we would have sustained an estimated \$800 million in *additional* losses (in other words, cumulative losses of more than \$1 billion) through the end of 2014 and almost certainly would have been forced out of business years ago. To have stayed in business at those higher rates, Pandora would have had to take drastic measures that would have deprived it of the ability to make the necessary investments that have allowed Pandora to grow its revenue from [REDACTED] in 2005 to a projected [REDACTED] for 2014 and to

build a business that has generated enormous royalties for sound recording copyright owners and recording artists. These measures almost assuredly would have included significantly curtailing listening on the service to manage Pandora's per-play royalty expenses (beyond such steps already undertaken in the past), which would have resulted in dramatically lower royalty payments to the record industry and reduced revenue to invest in operating expenses to grow the business. I estimate that the *best* Pandora could have grown, if subject to the higher *Web II* and *Web III* rates, is *half* as large as we are today – a level of activity that would have generated, at best, only 40% as much in sound recording royalties. That is, at these higher rates, record labels and recording artists would have been over a half billion dollars worse off in the short-term, and much worse off – hundreds of millions of dollars per year in foregone royalties – in the long-term. Going forward, were the Copyright Royalty Judges to set rates for 2016-2020 anywhere comparable to those set in the *Web III* proceeding (currently 0.23 cents per play), Pandora would face the same types of challenges resulting from its diminished ability to invest in the growth and monetization of its audience. We recognize that it is not the Judges' (or the record industry's) responsibility to ensure our survival – and we are not looking for a handout – but it is also clear that Pandora would not be a “willing buyer” at rate levels that would make it impossible to for us (or any other webcaster) to have the prospect of growing into a profitable business.

b) ***Pandora's creation of an Internet radio advertising market.*** In an effort to earn as much revenue as possible to cover its massive royalty costs – more than a billion dollars in the past seven years – Pandora has worked to create, essentially from scratch, a new market for audio Internet radio ads – a long, difficult, and expensive process that is only now coming to fruition. With an ever growing ad sales force, revamped sales platform and infrastructure, and continued education of media buyers, we are now competing directly for advertising dollars that

otherwise would go to terrestrial radio stations. Pandora has invested tens of millions of dollars to begin moving ad dollars from a platform that pays *no* royalties to record companies or artists to a platform that in 2014 alone expects to pay more than [REDACTED] in such royalties – and will pay even more as we continue to grow and improve our ability to monetize that growth. In order to do so, however, royalties must be set at reasonable levels that will allow us to continue making necessary investments in growing our ad sales team, innovating advertising products, and increasing the efficiencies of our ad-delivery technology to deliver a revenue stream sufficient to support a reasonable royalty to copyright holders.

c) ***Pandora-Merlin Agreement.*** After months of intense negotiation, Pandora recently concluded its first direct license agreement with Merlin, a global association of independent record labels. That agreement covers the precise performance rights and ephemeral reproduction rights covered under the Section 114 and 112 statutory licenses. I describe the negotiation and main deal points of the Merlin Agreement below.

The Outsized Impact of Sound Recording Royalties on Pandora's Finances

5. Since its inception in 2005, Pandora's revenues have grown from under [REDACTED] per year to a projected [REDACTED] for 2014.¹ Approximately 80% of our revenues come through the sale of advertising, with the remaining 20% generated through the sale of our subscription service, Pandora One, which does not have advertisements. To this day, however, the Company's costs exceed the revenues we are able to generate. As detailed in our most recent form 10-Q filed with the SEC (Pandora Exhibit 8), Pandora had a net operating loss of \$11.7 million for the three-month period ending June 30, 2014. In the first quarter of 2014, Pandora

¹ Since Pandora's Initial Public Offering in June, 2011, Pandora has filed 10-K forms on an annual basis and 10-Q forms on a quarterly basis with the SEC. These forms contain, among other things, Pandora's financials, including its revenues and expenses. The most recent 10-K form filed with the SEC is part of Pandora's 2014 Annual Report, which is attached hereto as Pandora Exhibit 6. The 10-Q forms for the first two quarters of 2014 are attached hereto as Pandora Exhibit 7 and Pandora Exhibit 8.

experienced an even greater net operating loss of \$28.9 million. Since Pandora was launched in 2005, the Company has amassed a cumulative net loss of more than [REDACTED].

6. Pandora's single most significant cost is the royalties paid to SoundExchange to publicly perform sound recordings, currently accounting for half its total costs and half its revenues.² Figure 1 below, covering the period 2007-2014, reflects this reality:

Fig. 1³ [RESTRICTED]



² By comparison, Pandora currently pays the performing rights organizations (ASCAP, BMI, and SESAC) and music publishers approximately [REDACTED] of revenue to publicly perform musical works. Pandora's remaining costs can be broadly grouped into the following categories: (i) sales and marketing costs; (ii) product development costs; and (iii) general and administrative costs. These cost categories are not limited to the general categories of costs that any music service must cover, but also the unique investments that Pandora has made that differentiate it from its closest competitors – terrestrial radio, Sirius XM, and other non-interactive webcasters. For example, we have spent more than [REDACTED] to date in developing and refining the Music Genome Project, including, among other things, the work done to develop the MGP and the 30 full-time musicologists who analyze the music that Pandora offers. In addition to developing the MGP, Pandora has spent more than [REDACTED] creating and refining the necessary infrastructure, hardware, and software (including our playlist creating algorithms) to offer a world-class radio product for each of our approximately 77 million active users.

³ In this and all other figures, the financial information depicted for 2014 is estimated based on the first eight months of the year.

7. Because of its sound recording performance royalty burden, which imposes a payment obligation with respect to every listener play, Pandora has repeatedly been forced to moderate the growth of its listener hours. For example, in July 2009, listeners to our advertising-supported desktop service were limited to 40 hours of listening per month, a cap that was not lifted until September 2011. In March 2013, Pandora temporarily limited listening hours on its mobile platform when mobile usage increased so drastically that we could not sell enough advertising inventory to cover the royalty costs associated with the extra hours. These caps on listening are blunt, but effective, instruments to curtail Pandora's royalty obligations. For example, the 2013 imposition of the mobile listening cap had the effect of reducing Pandora's royalty obligations by nearly [REDACTED]. They also, however, benefit neither Pandora nor the record industry over the longer term.

8. The sound recording payments reflected in Figure 1 above were those made to SoundExchange pursuant to a 2009 agreement calling for royalties at substantially lower levels than those set by the Judges in the *Web II* and *Web III* proceedings. Had these rates not been available to Pandora, and had we been remitted to paying at the *Web II* and *Web III* rates, our financial picture would have been substantially worse. Pandora's sound recording royalty expense alone, barring any other changes, would have eaten up more than 80% of its entire revenue base – and an additional \$800 million in expenses – over the 2007-2014 period, as represented in Figure 2 below. Indeed, in both 2008 and 2012, the royalty rates set in the *Web II* and *Web III* proceedings would have generated for Pandora a sound recording royalty expense accounting alone for more than 100% of our revenues.

Fig. 2 [RESTRICTED]



9. If Pandora had been able to survive at all under the *Web II* and *Web III* rates, it would have done so at great cost to building a viable long-term business. Among other measures, Pandora would have been forced to more severely limit the amount of listening on the service to reduce its royalty obligation; this, in turn, would have led to fewer total listeners, fewer listening hours against which advertising could have been sold, and much less investment in our advertising infrastructure, compounding the revenue losses from decreased listening. The combination of these factors would have created a vicious downward cycle, with the realistic prospect that Pandora would have been unable to acquire a large enough audience to be a meaningful platform on which advertisers would want to spend carefully allocated advertising dollars – not to mention being unable to fully invest in a sales force adequate to bring in those dollars.

10. If the rates set in this proceeding for the 2016-2020 license term were to be set at levels comparable to the *Web III* rates, it would have a similarly crippling effect on Pandora's

finances that would force Pandora to dramatically reduce listening, which would *reduce* royalties paid, both in the near and long-term. While our advertising rates and revenues are increasing steadily (as I discuss below), that revenue growth would be far outstripped by the costs we would incur from royalty rates set at *Web III* levels. [REDACTED]

[REDACTED]. It defies logic to suggest that we would willingly negotiate royalty payments that would cause us to continue to sustain net losses for many additional years; it is equally implausible that record labels operating in a competitive marketplace would insist on royalties at a level that would jeopardize the continued flow of enormous royalties from by far the largest webcaster in operation.

Pandora's Contributions to the Internet Radio Audio Advertising Market

11. Pandora derives more than 80% of its revenue from the sale of advertising. Pandora has consistently sought to maximize advertising revenue by expanding the types of advertisements that we offer, and expanding our sales and sales marketing staff to compete for advertising spending that would otherwise go elsewhere, including to traditional radio stations. As I describe in this section, we are seeing impressive gains both in the rates we are able to charge advertisers and in our overall ads sales levels, but it is an ongoing process that requires significant and ongoing investment – in infrastructure, engineering, and above all ad sales staff – to maintain our upward trajectory. To the extent we experience a rapid increase in our royalty payments, it necessarily will impede our ability to make such investments and grow our revenues in a way that ultimately will benefit both Pandora and sound recording owners and artists.

12. At the time of Pandora's launch, most Internet radio services relied primarily on display ads (banner ads and the like) just like any other Internet-based services, and there was no

meaningful market for in-stream audio ads on webcasts like one would hear on traditional radio stations. Advertising agencies typically reflected this split, maintaining separate online or “digital” ad sales apart from the traditional (and much larger) portion of their budgets that covered radio, television and print ads. Not only were the digital and radio budgets kept separate, but different personnel at advertisers and agencies tended to handle each segment of the ad-buying strategy. Pandora recognized from the beginning that for it to be able to maximize its advertising revenue, Pandora needed to tap into the \$15 billion radio advertising market, first by selling “national” audio ads (which would run across our entire user base), and eventually, as we gained sufficient scale in individual markets, by competing for local advertising dollars – far away the largest and most lucrative component of that \$15 billion market.⁴ Pandora recognized that it would have to endure potentially significant financial losses for a period of time in order to grow an audience large enough to attract local advertisers and thereby effectively monetize our listener hours and become a profitable business.

13. Advertisers, however, were not familiar with Pandora, where it fit within the radio market, or what role it might play in their radio advertising strategies and budgets. Reflecting the split mentioned above, they tended to lump Pandora together with other digital platforms for visual advertising (such as “banner” or other display ads on Google or Facebook), not *audio* advertising. Advertisers’ hesitance to expand their radio budgets to Pandora also was fostered by their inability to place advertisements with Pandora through the automated ad-placement systems to which they had grown accustomed in the terrestrial radio context, as well as a lack of any

⁴ Radio advertising is typically divided into three categories. “Network” ads are not geographically targeted, and run on stations nationwide; these ads make up only about \$1 billion of the overall radio advertising market. “Spot” ads are typically purchased by large, national advertisers but are regionally or locally targeted; these ads account for the vast majority of the market, at about \$10 billion. The remainder of the market is composed of “local” ads, which are typically limited to a single market. To sell spot or local ads, a service must have sufficient audience scale in those given markets to be attractive to advertisers seeking to reach a specific audience.

metrics that would allow them to compare Pandora's reach in the same terms traditionally used to measure the reach of terrestrial radio stations.

14. The need to develop an audio advertising market for Internet radio intensified with the introduction of the Pandora mobile app in 2008 and the dramatic shift from desktop to mobile listening that resulted. (Today, more than 80% of our listening is on mobile and other portable devices.) Digital banner ads became less attractive for Pandora's advertisers, since mobile listeners tend not to look at their screens or interact with the service as much as desktop listeners. Mobile access also led to a massive increase in listening hours. Spending on mobile advertising, however, lagged behind this shift in audience, making it difficult for Pandora effectively to monetize this massive change in listener behavior and find buyers for all the advertising space it had to offer.

15. To effectively break into the \$15 billion radio advertising market (and, more particularly, the local and national "spot" markets comprising \$14 billion of that total), Pandora needed to build relationships with entirely new advertising buyers and to communicate with them in the language they used when purchasing radio advertising space. One tool that helped us change traditional conceptions was Pandora's development of listener metrics to allow advertisers to compare Pandora's reach to that of traditional radio stations. A consumer research firm called Arbitron (now called Nielsen Audio) tracked and reported listener data on terrestrial radio, essentially showing advertisers how many people (on average) are listening at any given time, and in what local area – crucial information for an advertiser looking to determine where to place its advertising dollars. Arbitron did not track listener metrics for Pandora. It was effectively impossible for Pandora to break into the radio advertising market without being able to report to advertisers in the language they used to purchase radio spots: "cume" (measuring the

total number of unique listeners to a station in a given period of time) and “average quarter hour” (AQH) (the average number of listeners for a given station in a quarter hour). To that end, in May 2012, Pandora announced a partnership with Triton Digital, the second largest provider of radio audience measurement data behind Arbitron. This partnership with Triton took considerable effort on Pandora’s part, but these efforts have borne fruit: it is now possible to quantify the size and scale of Internet radio at both national and local levels.

16. Another major challenge that impeded Pandora’s ability to break into the traditional radio advertising market was the fact that Pandora was not integrated into the ad-buying software platforms used by media buyers and ad agencies, through which approximately 70% of spot purchases are made. We tackled this challenge head-on: in March 2013, Pandora announced that Triton’s metrics for Pandora would be integrated into STRATA and Mediaocean, the two most popular audio ad buying platforms, to facilitate comparisons between different audio advertising options.⁵ Earlier this year, Pandora also was integrated into Telmar, the advertising industry’s leading strategy and planning platform that is routinely used in connection with the buying platforms. As a result, Pandora is now available on popular strategy and buying platforms alongside its terrestrial radio competitors.

17. A third challenge Pandora faced in tapping into the radio advertising market was its initial inability to get a foothold in the massive market for local advertising (leaving us relegated to the much smaller and less lucrative national network slice of the radio advertising pie) because Pandora could not target ads to users in specific locations. We eventually developed the ability to use listener zip codes to track and serve them ads locally. After starting

⁵ As Bloomberg.com recognized when it reported this development in March 2013, the change helped “eliminate[] a hurdle for ad buyers and Pandora.” A true and correct copy of the article *Pandora Gains Access to \$14 Billion Radio Ad-Sales Market*, published on March 5, 2013 (available at www.bloomberg.com/news/2013-03-05/pandora-gains-access-to-14-billion-radio-ad-sales-market.html) is attached hereto as Pandora Exhibit 9.

with the top ten local radio markets in the first quarter of 2012, Pandora now uses that capability to sell local ads across virtually all major metro survey areas in the U.S. (We are the top ranked station in terms of weekly listening in 14 of the top 15 markets.) Pandora's efforts to unlock local audio advertising are set forth in our most recent investor presentation from the second quarter of 2014, a true and correct copy of which is attached hereto as Pandora Exhibit 10.

18. In conjunction with the above-described innovations – which came at a cost of approximately [REDACTED] since 2011 – Pandora has had to invest heavily in growing its sales organization. Today, just like most of our terrestrial radio competitors, Pandora operates local sales teams in radio markets, large and small, across the country. As we have penetrated more deeply into local ad sales markets, we have often hired advertising salespeople directly away from local radio stations. Between 2012 and 2013, Pandora grew from about 700 employees to nearly 1,100, and most of the new hires were advertising salespeople, including in New York, Los Angeles, Dallas, San Francisco, Chicago and Seattle; by the end of 2014, we expect to have grown to about [REDACTED] employees. We now have local sales forces in 36 of the top radio markets, with plans to continue to invest more deeply in our existing markets and to expand physical coverage to [REDACTED].⁶ Since Pandora launched, we have spent tens of millions in building this sales force – and a robust sales support organization to assist it. The total budget for our sales organization has increased from [REDACTED] in 2010 to [REDACTED] in 2014, and it comprises about 60% of our employees.

19. In addition to investments in our advertising sales force, we have heavily invested in new advertising products. Serving advertisements is not as easy as one might think.

⁶ The growth of this sales organization has been critical to Pandora's ability to gain a foothold in the local advertising market, as was recognized by the New York Times in April 2012. A true and correct copy of the article *Pandora Courts Local Advertisers, by Offering Well-Defined Listeners*, published in the New York Times on April 15, 2012, is attached hereto as Pandora Exhibit 11.

Advertisers want to reach a particular audience at a particular time and in a particular context. For example, advertisers not only want to reach a particular age and gender demographic, but also want to know that an advertisement for a competing product was not just served to a targeted listener. Adding to the complexity of ad delivery, the Pandora service is delivered through a variety of computing devices, such as PCs, tablets, and smartphones. We have had to develop technology that allows us to provide the same advertising experience across all of these device types, which have different screen sizes and profiles. In addition, we have developed new segments of ad products, such as video advertisements and “sponsored” listening, in which a listener is granted some period of ad-free listening in exchange for engaging with an advertisement.

20. Our efforts to drive increased monetization of Internet radio through the sale of audio ads are finally beginning to pay off. Our local advertising sales revenue has grown approximately 180% between the first half of 2013 and the same period in 2014, and a substantial proportion of our spot sales are now directly traceable to terrestrial ad budgets.⁷ Pandora has increased not just its overall sales, but the ad revenue it earns for given levels of usage, particularly with respect to mobile listening. Ad RPM (*i.e.*, revenues per thousand listening hours that are attributable specifically to advertising) specific to mobile and other connected devices increased from \$22.25 in the second quarter of 2012 to \$32.56 in the second quarter of 2013 to \$36.00 in the second quarter of 2014 – a nearly 62% increase in just two years. Our total ad RPM (desktop and mobile combined) has grown from \$37.89 in the second

⁷ We know this based on the language the buyers use when negotiating price on our advertising space; that is, rather than negotiate based on CPM (cost per thousand impressions) as they would do in the traditional digital space, they are negotiating off cost per rating point, as they would do in the radio space. We can also tell that we are dealing with the same ad buyers as radio based on their titles or roles within their agency or company – for example, our salespeople routinely interact with ad buyers whose job titles are Broadcast Account Manager or similar.

quarter of 2013 to \$40.11 in the second quarter of 2014.⁸ That said, we still have much work to do. The mobile audio advertising market is still quite nascent, and advertisers' buying on new platforms historically has lagged significantly behind the shift in audience to such platforms. But we are beginning to see real changes in the understanding of advertisers regarding Pandora's role in the radio market. As these trends continue, we are hopeful that shift will be reflected in improved sell-through and rates closer to those the terrestrial radio industry has been able to achieve.

21. The bottom line is that Pandora has invested tens of millions of dollars to begin moving ad dollars from a platform that pays *no* royalties to record companies or artists to a platform that, in 2014, will pay more than [REDACTED] in such royalties – and will pay even more as we continue to grow and improve our ability to monetize that growth. Pandora's size and popularity is not itself a basis for a major increase in royalty rates. Royalties should instead be set at levels that will enable the unique platform that Pandora has built to be sustainable, that will permit the necessary investments to be made toward that end, and that will thereby best emulate what a willing buyer (Pandora) would be willing to pay willing sellers in a competitive market (record labels and artists in such a market) seeking to continue to benefit from the sizeable and growing royalty streams that only a successful Pandora can afford them.

Pandora's Direct License with Merlin

22. Over the past couple of years Pandora has begun to explore negotiating licenses directly with record labels rather than relying solely on the statutory license. As an initial matter, we undertook an investigation into whether it would be possible to perform the sound recordings of certain independent record labels more than Pandora currently did. As a management team,

⁸ Ad RPM on desktop, which is a relatively established advertising market, has been over \$60 for some time, and was \$62.43 in the second quarter of 2014.

we wanted to understand whether Pandora could actually realize a financial benefit by securing performance rights at economically advantageous rates; that is, if Pandora had an economic incentive to perform certain sound recordings more than others, could Pandora actually perform such sound recordings more frequently without affecting listenership? We instructed our Engineering team, specifically our scientists, to design and conduct experiments to answer this question. These experiments were designed and implemented in the summer and fall of 2013. Based on the results of those experiments, which demonstrated that Pandora could alter the spins of certain independent labels by [REDACTED] or more, we began to formulate a strategy to negotiate direct licenses with record labels.

23. As part of this effort I and others at Pandora have had discussions with a number of record labels regarding the possibility of direct licensing. From our perspective, direct licensing offers an opportunity that relying solely on statutory licensing does not: letting the marketplace itself determine the reasonable level of fees for sound recording performance rights in an environment in which individual licensors can compete with one another for the opportunity for increased plays on Pandora.

24. On June 16, 2014, Pandora entered into its first direct license, with Music and Entertainment Rights Licensing Independent Network, B.V. (“Merlin”) – a global rights agency that represents thousands of leading independent record labels. The Merlin agreement is attached hereto as Pandora Exhibit 12, and covers the public performance of recordings in the repertoires of participating Merlin labels, as well as ephemeral copies necessary to make such performances.⁹ The Merlin agreement took several months to negotiate, growing from a simple two-page term sheet to the more extensive agreement we eventually executed. Its final form

⁹ On July 11, 2014 Merlin and Pandora entered into the First Amendment to the Merlin Agreement. A true and correct copy of the First Amendment is attached hereto as Pandora Exhibit 13.

reflects substantial give and take from both sides, including a number of provisions that Merlin insisted upon, without which the agreement almost certainly would not have been reached. For example, our initial proposal, made in November of 2013, proposed a [REDACTED], which Pandora believed would fairly compensate record labels for their sound recordings while enabling Pandora to grow its business (and, ultimately, pay record labels even more royalties). We ultimately accepted Merlin's request for [REDACTED], but succeeded in obtaining various other provisions allowing Pandora to achieve its targeted [REDACTED]. The key terms of the Merlin Agreement are set out in the following paragraphs.

25. **Term.** The Merlin agreement provides for an initial [REDACTED]

[REDACTED]
[REDACTED]

26. **Royalty Payments.** The Merlin agreement incorporates a [REDACTED]

[REDACTED], in which Merlin labels receive [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

27. **Steering.** [REDACTED]

[REDACTED]

[REDACTED]¹⁰ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

28. **Compensable Performances.** [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¹⁰ Specifically, Pandora can increase performances of Merlin-label tracks by as much as [REDACTED] without increased payments, which results in a decrease in the effective per-performance payment. Pandora fully intends to increase spins of Merlin-label tracks by at least the required [REDACTED].

P [REDACTED]

[REDACTED]

29. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

30. **Promotional Benefits.** In addition to the price-related terms set forth above, the Merlin agreement provides covered labels with certain additional promotional benefits. For example:

- **Advertising availability:** [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

- **Fan Outreach:** [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

- **Bumpers:** [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

- **Metrics:** [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
- **Merlin Label Stations:** [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]¹¹
- **Pandora Presents/Premieres:** [REDACTED]
[REDACTED]¹²

Collectively, the cost of these promotional benefits is estimated by Pandora to be minimal when compared to the other terms of the agreement.

31. The “steering” aspect of the Merlin agreement is worthy of special attention. Unlike with industry-wide agreements at fixed per-performance rates that apply equally to all performances, this agreement provides Pandora with the financial incentive, for the first time, to increase its use of Merlin-label tracks without an increase in fees – thus lowering its per-performance payment. As noted above, in order to ensure there is no degradation to the current listening experience and prior to entering into direct license negotiations, Pandora has, over the

¹¹ [REDACTED]

¹² These events are described in more detail in the Written Direct Testimony of Simon Fleming-Wood.

[REDACTED]

last 15 months, spent considerable time testing the impact that increasing or decreasing the spins of individual labels has on the overall quality of the service. As detailed in the accompanying testimony of Stephan McBride, Pandora has considerable flexibility to substitute tracks of one label for those of others – both independent and “major” labels¹³ – if provided with the financial incentive to do so, with no discernible impact on listener satisfaction metrics.

32. Based on this testing, we anticipate that we will be able to take full advantage of the lower-priced per-performance rates that result from the increased use of Merlin tracks. We are currently identifying the particular tracks covered by the Merlin agreement and executing the changes to our playlist algorithms to put such steering into practice on our service. That identification process should be complete early in the 4th quarter of 2014, at which point we anticipate being able to increase the spins of Merlin-label tracks by [REDACTED] (the increase necessary to cover the above-described guarantee) or more, a figure our testing suggests can easily be one without any impact on listening.

33. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

¹³ For example, our experiments revealed that we could “steer” towards or away from [REDACTED] (each independent labels), as well as [REDACTED] by well more than [REDACTED] without any material impact on user satisfaction or listening patterns.

¹⁴ [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[REDACTED]

34. As of the date of this testimony, approximately [REDACTED] Merlin member labels have “opted in” to the Merlin agreement. Thus, as of today, the Merlin agreement grants Pandora the necessary sound recording public performance and ephemeral reproduction rights – the same rights as are at issue in this proceeding – to play more than [REDACTED] tracks recorded by [REDACTED] artists on our service. Before accounting for any “steering” of plays, the sound recordings covered by the agreement account for approximately [REDACTED] of all spins on Pandora.

35. Numbers aside, the Merlin agreement covers recordings by some of the most popular and prominent artists played by Pandora, including winners of Grammys and other major record-industry awards. To provide just a few examples:

- **Merge:** This label’s catalog includes the album *The Suburbs* by the acclaimed band Arcade Fire. *The Suburbs* won the Grammy for Album of the Year at the 53rd Annual Grammy Awards in 2011. Arcade Fire’s debut album *Funeral* was nominated for the Grammy for Best Alternative Music Album in 2005. Both *Funeral* and *The Suburbs* are certified platinum by the RIAA.
- **Beggars:** This record company owns and distributes several other labels, including XL Recordings, Matador, and 4AD. The Beggars Group’s catalogs cover the popular bands:
 - **Vampire Weekend:** This band’s third studio album, *Modern Vampires of the City*, won the Grammy for Best Alternative Music Album in 2014. Vampire Weekend’s albums *Contra* and *Vampire Weekend* are both certified gold by the RIAA, as is their single, “A-Punk.”
 - **Interpol:** This band’s albums *Turn on the Bright Lights* and *Antics* have both been certified gold by the RIAA. They have released three albums with Matador that each peaked at #2 on the Billboard Alternative Albums and Top Rock Albums charts.

- **The National:** This band released two albums with 4AD – *Trouble Will Find Me* and *High Violet* – that each peaked at #3 on the Billboard 200 chart. *Trouble Will Find Me* also was nominated for a Grammy Award in the Best Alternative Music Album category in 2014.

The Beggar Group’s catalog also includes Belle & Sebastian’s album *Write About Love*, which in 2010 reached #15 on the Billboard 200 chart, and peaked at #2 on the Top Independent Albums chart, #3 on the Alternative Albums chart, and #4 on the Top Rock Albums chart. All of these artists regularly perform to sold-out audiences and frequently perform at major music festivals such as Governor’s Ball, Coachella, and Austin City Limits.

- **Epitaph:** This label released The Offspring’s hit album *Smash* in 1994. Fueled by hit singles “Come Out and Play,” “Self Esteem,” and “Gotta Get Away,” the album set an all-time record for most units sold by an independent label band, at 16 million records. *Smash* has continued to sell consistently well in the twenty years since its release, and has been certified six-times platinum in the U.S. Epitaph’s catalog also includes Bad Religion, whose albums *Christmas Songs* and *New Maps of Hell* both reached #7 on the Hard Rock Albums chart.
- **ANTI-:** This sister label to Epitaph released the acclaimed album *The Whole Love* by Wilco, which peaked at #5 on the Billboard 200 chart in 2012 and was nominated for a Grammy Award in the Best Rock Album category. ANTI- also released Tom Waits’s album *Mule Variations*, which won the Grammy Award for Best Contemporary Folk Album in 2000 and was certified gold by RIAA. Waits’s albums *Real Gone* and *Bad as Me* each topped Billboard’s Top Independent Albums chart. Alternative country artist Neko Case released her fifth studio album *Middle Cyclone* with ANTI-, which peaked at #3 on the Billboard 200 chart and topped the Independent Albums Chart in 2009; Case’s 2013 ANTI- album *The Worse Things Get, The Harder I Fight, The Harder I Fight, The More I Love You* also topped the Billboard Independent Albums chart and hit #5 on the Top Rock Albums chart.
- **Domino:** This label’s roster includes Animal Collective and Arctic Monkeys. Domino celebrated its first UK #1 single with Arctic Monkey’s “I Bet You Look

Good on the Dancefloor” in October 2005. Animal Collective’s 2009 album *Merriweather Post Pavilion* topped the year-end “best of” lists of dozens of critics around the country.

- **Razor & Tie:** One of the largest privately-owned independent labels in North America, Razor & Tie has sold over 40 million units and has won multiple Grammy Awards in its more than 20 years in the recording business. Razor & Tie’s diverse catalog represents rock artists such as All That Remains and For Today, as well as world music such as artist Angelique Kidjo, whose album *Djin Djin* won the 2007 Grammy for Best Contemporary World Music Album, and Ladysmith Black Mambazo, who were nominated for a Grammy Award in the Best World Music Album category in 2012. Razor & Tie is also a leader in children’s music: their Kidz Bop series has amassed more than twenty #1 albums on the Billboard Kids’ Album chart, fourteen Top 10 hits on the Billboard 200 chart, and nine gold records.
- **Jagjaguwar:** Co-founded by Darius van Arman, a member of SoundExchange’s board of directors, this label’s catalog covers indie rock band Bon Iver, which won the 2012 Grammy Award for Best New Artist and whose album *Bon Iver*, *Bon Iver* won the 2012 Grammy Award for Best Alternative Music Album.
- **ATO:** This label’s catalog includes the rock band Alabama Shakes, which was nominated for a Grammy Award in 2012 for Best New Artist and for a BRIT Award for Emerging Artist of the Year. Alabama Shakes’ debut album *Boys & Girls* peaked at #6 on the Billboard 200 chart, topped the Independent Albums chart, and is certified gold by the RIAA. ATO has also four albums by rock band My Morning Jacket, including the 2011 album *Circuital* and 2009 album *Evil Urges*, both of which were nominated for Grammy Awards in the Best Alternative Music Album category. Soul singer Allen Stone’s self-titled album was re-released by ATO in 2012, and peaked at #4 of Billboard’s Top Heatseekers chart.

36. We are hopeful that the Merlin agreement will be the first of many direct deals that more fully embrace the workings of a competitive marketplace in which labels compete with

each other on price to have their works performed on the Pandora service. In fact, we have already started to discuss such possibilities with a number of labels that are not represented by Merlin. These negotiations, while ongoing, appear to be promising.

Pandora's Proposed Rates and Terms

37. The Rates and Terms proposed by Sirius XM are intended to conform with Professor Shapiro's analysis of the Merlin Agreement and to make certain other technical and conforming changes, several of which I highlight here:

- Definition of "Performance": Because Pandora and other Internet radio providers may offer transmissions to listeners outside the U.S. (where they will be licensed according to the legal requirements of the foreign country), the regulations should make clear that only those transmissions to users in the United States are properly compensable under the Section 112 and 114 licenses.
- Definition of "Revenue": Consistent with our Merlin agreement, the applicable revenue base is limited to advertising and subscription revenue on channels making eligible transmissions subject to the Section 112 and 114 statutory licenses. Pandora revenue earned from other activities, or channels making only incidental performances of sound recordings, should be (and is) excluded.
- Direct-license credit: The proposed regulations provide a credit for directly licensed performances so that the Licensee is not double paying for the same performances (i.e., one payment to the direct licensor, one payment to SoundExchange). Consistent with the Judges' ruling in the *Satellite II* proceeding, in situations where the Licensee is paying under the percent-of-revenue prong of the rate formula, the regulations provide a discount from fees owed proportional to the percentage of Licensee performances that are directly licensed.
- Ephemeral recording fee: Consistent with past proceedings and the Merlin agreement (which has no separate ephemeral recordings fee), Pandora proposes that the royalty payable for ephemeral recordings be included within the Section

114 royalty. We have proposed a technical modification to the prior language, which prescribed a royalty for ephemeral recordings to be used “solely to facilitate transmissions for which [Licensee] pays royalties.” Because the definition of “Performance” exempts certain uses (for example, incidental uses) from payment, the allowance for ephemeral recordings should not be limited “solely” to paid uses.

- Late payment fee: We propose a revision to make clear that in the event the Licensee’s payment and statement of account are late, only a single late fee shall be assessed. A single late fee is more than sufficient to motivate licensees to make timely payments and accounting; duplicative payments (which would add up to 3.0% per month, or 36% per year) are unnecessary, and would be unreasonable and usurious.
- Statement of account signature: SoundExchange has recently taken the position with Pandora that we cannot revise or adjust a previously submitted statement of account because the first version submitted was certified as accurate under the existing signature requirement in the regulations. Although we make every attempt to ensure that our statements of account are true and accurate, that should not prevent us from revising and resubmitting those statements if, in good faith, we discover that we have miscalculated our statutory liabilities in some way. The object should be getting it right and making sure SoundExchange’s members are paid properly. Accordingly, we propose a revised regulation to address this situation.

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
THE LIBRARY OF CONGRESS
Washington, D.C.

In re

DETERMINATION OF ROYALTY
RATES AND TERMS FOR
EPHEMERAL RECORDING AND
DIGITAL PERFORMANCE OF
SOUND RECORDINGS (*WEB IV*)

Docket No. 14-CRB-0001-WR (2016-2020)

DECLARATION OF MICHAEL HERRING

I, Michael Herring, declare under penalty of perjury that the statements contained in my Written Direct Testimony in the above-captioned proceeding are true and correct to the best of my knowledge, information, and belief. Executed this 6th day of October 2014 in Oakland, California.


Michael Herring



PANDORA[®]

2014 Annual Report



250,000,000^{*}
Registered Users



1,000,000+
Songs in the Pandora® collection



40,000,000,000+^{**}
Thumbs



U.S., Australia,
& New Zealand

Pandora®

Business Model



Music Genome Project

- Comprehensive database of music analysis
- Up to 450 attributes per song



Collective Feedback

- 40+ billion thumbs in aggregate
- 6+ billion stations created



Individual Engagement

- Real-time adaptation of playlists



Advertising

- Display, audio, and video advertising solutions
- Multi-platform: computers, smartphones, automotive, CE devices
- National and local



Anytime. Anywhere.

The header features a dark blue background with a pattern of overlapping circles in various shades of blue and teal. The word "PANDORA" is written in a large, white, sans-serif font, followed by a registered trademark symbol. To the right of the logo, the text "To Our Stockholders" is written in a smaller, white, sans-serif font.

PANDORA® To Our Stockholders

I was very excited to become Pandora's Chief Executive Officer in September 2013. I am proud to be part of such a strong and successful organization with a 14-year history driving forward the future of radio. Our vision is to make the future of radio highly personalized to each listener's tastes, provide exposure to the broadest possible number of artists and genres, and offer a targeted and efficient platform for advertisers. We are working quickly to create this future, and doing so in ways that terrestrial radio simply can't match.

In 2013, Pandora delivered strong financial and operational growth. At the end of the 11 months ended December 31, 2013, listener hours grew to 15.31 billion from 12.56 in 2012, and active users for the 30 day period ended December 31, 2013 increased to 76.2 million. Non-GAAP total revenue for the 12 months ended December 31, 2013 reached \$647.5 million, an increase of 56% from the prior year; this revenue growth was driven in particular by our focus on mobile, where we grew total mobile ad revenue 69% to \$366.3 million. Mobile monetization from advertising on mobile and other connected devices reached a record high RPM of \$30.93 for the year, an increase of 40% from the same period last year.

Importantly, Pandora has a significant runway for growth. As one of the few media companies operating at scale across multiple platforms, Pandora has been able to tap into both the \$20B plus digital advertising market and, more recently, take part in the \$15B US radio business. At the end of 2013, according to our estimates which include third party data, Pandora's market share of all U.S. radio listening was 8.6%, up from 7.6% a year earlier.

For our consumers, it starts with delivering a highly personalized experience. Put simply, we benefit from deep musical expertise and proprietary technology, including the Music Genome Project. As millions of listeners actively engage with Pandora, telling us what they like and dislike, we've accumulated 40+ billion pieces of thumb feedback over our history, which helps us further hone our playlist technology and provides insights we can use with advertisers and the artist community. In 2013, we continued to invest in listener engagement, including introduction of product enhancements such as a station recommendations engine, alarm clock functionality, and a sleep timer.

Consumers are also benefiting from our ongoing efforts to become as ubiquitous as radio. That's why we've invested significantly to make Pandora available in the home, in the office, in the car, or on any connected device. In 2013, we came closer to seeing this goal become a reality. Pandora is now available on 9 out of 10 of the best-selling passenger vehicles, and more than 4 million unique users have activated Pandora through a native integration across 25 major automotive brands and eight aftermarket manufacturers that we partner with. Throughout 2013, we expanded our automotive partnerships with GM, Chrysler, Mazda, Hyundai, Toyota, Nissan, and Honda.

In 2013 we successfully monetized our business by using our technology and expertise to effectively connect advertisers with one of the largest and most engaged listener bases in the world. While Pandora has long been considered a leader in using data to deliver the right song to the right person at the right time, we're leveraging that expertise to introduce advanced targeting advertising capabilities. This is particularly

important as advertisers reduce their reliance on cookies, which we are not dependent on. Additionally, through our integrations with leading platforms like Strata, Media Ocean and Triton, we continued to help advertisers make data-driven side-by-side comparisons between Pandora and terrestrial radio data.

Finally, when it comes to the artist community, Pandora offers one of the most powerful platforms ever created to connect artists with fans. We deliver tremendous value to artists of all sizes through discovery and promotion, offering access to one of the single largest potential music audiences ever assembled. And looking toward the future, we are moving aggressively to harness the power of our data and insights to help artists understand, grow and engage their fan base on Pandora.

2014 Goals

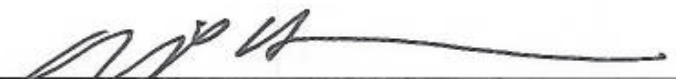
We have three priorities for 2014. First, we are focused on continuing to grow our active listeners and listening hours. We are increasing our investments in the product to optimize the listener experience by having the best playlist experience on the market and adding innovative new features. We will continue to invest in our “Pandora Everywhere” strategy including executing on our mission of being part of the first connected cars rolling out this year. And we will significantly increase our marketing spend to ensure our listeners are well informed of all of these new developments.

Second, we plan to continue our progress in improving monetization. We will continue our investment in sales expansion and new and innovative advertising products, including better ad targeting in ways that only the internet and our breadth of user data allow us to do. And we will continue to work with the industry to ensure that we are integrated into the advertising infrastructure in ways that helps advertisers better understand our value.

Finally, we will continue to focus on managing our cost of content. We will increase our engagement with people across the music and radio industry – including artists, labels, and competitors – to ensure that we are building relationships and staying abreast of all key developments in this rapidly changing royalty environment. We may not always agree with others in the ecosystem, but it’s important that we understand each other’s objectives and work to find common ground where we can.

Above all, we will continue to work towards our mission of enriching people’s lives by enabling them to enjoy music they know and discover new music that they’ll love.

Thank you to our users, our advertising partners and to our shareholders for your support and encouragement. We made good progress towards realizing our goals in 2013 and we are excited about our future.



Sincerely,

Brian McAndrews
Chairman, CEO & President
Pandora Media Inc.

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

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

or

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

For the transition period from February 1, 2013 to December 31, 2013

Commission File Number: 001-35198

Pandora Media, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

94-3352630

(I.R.S. Employer
Identification No.)

2101 Webster Street, Suite 1650

Oakland, CA

(Address of principal executive offices)

94612

(Zip Code)

(510) 451-4100

(Registrant's telephone number, including area code)

Securities registered pursuant to section 12(g) of the Act:

Title of each class

Common stock, \$0.0001 par
value

**Name of each exchange on
which registered**

The New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☒

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 on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

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 aggregate market value of the voting common stock held by non-affiliates of the registrant as of July 31, 2013 (the last business day of the registrant's most recently completed second quarter), based on the closing price of such stock on The New York Stock Exchange on such date was approximately \$1,568 million. This calculation excludes the shares of common stock held by executive officers, directors and stockholders whose ownership exceeds 5% outstanding at July 31, 2013. This calculation does not reflect a determination that such persons are affiliates for any other purposes.

On February 6, 2014 the registrant had 197,423,063 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement relating to its 2014 annual meeting of stockholders, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Transition Report on Form 10-K where indicated. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant's transition period ended December 31, 2013. Except with respect to information specifically incorporated by reference in this Transition Report on Form 10-K, the Definitive Proxy Statement is not deemed to be filed as part of this Transition Report on Form 10-K.

PANDORA MEDIA, INC.
FORM 10-K
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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND INDUSTRY DATA

This Transition Report on Form 10-K contains "forward-looking statements" that involve substantial risks and uncertainties. The statements contained in this Transition Report on Form 10-K 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 Securities Exchange Act of 1934, as amended (the "Exchange Act"), including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses and plans and objectives of management. 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 Transition Report on Form 10-K. 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. In addition, the industry in which we operate is subject to a high degree of uncertainty and risk due to a variety of factors including those described in the section entitled "Risk Factors." These and other factors could cause our results to differ materially from those expressed in this Transition Report on Form 10-K.

Some of the industry and market data contained in this Transition Report on Form 10-K are based on independent industry publications, including those generated by Triton Digital Media or "Triton" and International Data Corporation or "IDC" 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 contains 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.

EXPLANATORY NOTE REGARDING THE TRANSITION REPORT

We changed our fiscal year to the calendar twelve months ending December 31, effective beginning with the year ended December 31, 2013. As a result, our current fiscal period was shortened from twelve months to an eleven-month transition period ended on December 31, 2013. We reported our third fiscal quarter as the three months ended October 31, 2013, followed by a two-month transition period ended December 31, 2013.

When financial results for the 2013 transition period are compared to financial results for the prior year period, the results compare the eleven-month periods ended December 31, 2013 and December 31, 2012. The results for the eleven month period ended December 31, 2012 are unaudited. When financial results for fiscal 2013 are compared to financial results for fiscal 2012, the results compare our previous fiscal years, or the twelve-month periods ended January 31, 2013 and January 31, 2012. The following tables show the months included within the various comparison periods:

Calendar 2013 (11-month) Results Compared With Calendar 2012 (11-month recast, unaudited)

Calendar 2012 (11-month recast, unaudited)	Calendar 2013 (11-month)
February 2012 - December 2012	February 2013 - December 2013

Fiscal 2013 Results Compared With Fiscal 2012

2012	2013
February 2011 - January 2012	February 2012 - January 2013

PART I.

ITEM 1. BUSINESS

Overview

Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers, car audio systems and a range of other internet-connected devices. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to create stations initially and then adapt playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements.

As of December 31, 2013, we had more than 200 million registered users, which we define as the total number of accounts that have been created for our service at period end. As of December 31, 2013 approximately 175 million registered users have accessed Pandora through smartphones and tablets. For the eleven months ended December 31, 2013, we streamed 15.31 billion hours of radio and as of December 31, 2013, we had 76.2 million active users during the prior 30 day period. According to a September 2013 report by Triton, we have more than a 70% share of internet radio among the top 20 stations and networks in the United States. Since we launched our free, advertising-supported radio service in 2005, our listeners have created over 5 billion stations.

Our Service

Unlike traditional radio stations that broadcast the same content at the same time to all of their listeners, we enable each of our listeners to create up to 100 personalized stations. The Music Genome Project and our playlist generating algorithms power our ability to predict listener music preferences, play music content suited to the tastes of each individual listener and introduce listeners to music they will love. When a listener enters a single song, artist or genre to start a station—a process we call seeding—the Pandora service instantly generates a station that plays music we think that listener will enjoy. Based on listener reactions to the songs we pick, we further tailor the station to match the listener's preferences.

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 across all of our delivery platforms.
- *Pandora One.* Pandora One is provided to paying subscribers without any external advertising. Pandora One allows listeners to have more daily skips and enjoy higher quality audio on supported devices.

Beyond song delivery, listeners can discover more about the music they hear by researching song lyrics, reading the history of their favorite artists, viewing artist photos and buying albums and songs from Amazon or iTunes. Our service also incorporates community social networking features. Listeners can create and customize personal listener profile pages to connect with other listeners. Our music feed feature enables a real-time, centralized stream for listeners to view the music that their social connections are experiencing and to provide and receive recommendations for songs, albums and artists. Listeners can also share their stations across other social media outlets and through email by using our share feature or by distributing our individualized station URLs.

Our Technologies

At the core of our service is our set of proprietary personalization technologies, including the Music Genome Project and our playlist generating algorithms. When a listener enters a single song, artist or genre to start a station, the Pandora service instantly generates a station that plays music we think that listener will enjoy. Based on listener reactions to the songs we stream, we further tailor the station to match the listener's preferences in real time.

Music Genome Project

The Music Genome Project is a database of over 1,000,000 uniquely analyzed songs from over 100,000 artists, spanning over 500 genres and sub-genres, which we develop one song at a time by evaluating and cataloging each song's particular attributes. Once we select music to become part of our catalog, our music analysts genotype the music by examining up to 450 attributes including objectively observable metrics such as tone and tempo, as well as subjective characteristics, such as lyrics, vocal texture and emotional

intensity. We employ rigorous hiring and training standards for selecting our music analysts, who typically have four-year degrees in music theory, composition or performance, and we provide them with intensive training in the Music Genome Project's precise methodology.

Comedy Genome Project

Our Comedy Genome Project leverages similar technology to the technology underlying the Music Genome Project, allowing a listener to choose a favorite comedian or a genre as a seed to start a station and then give feedback to personalize that station. Our comedy collection includes content from more than 1,500 comedians with more than 25,000 tracks.

Our Other Core Innovations

In addition to the Music Genome Project, we have developed other proprietary technologies to improve delivery of the Pandora service, enhance the listener experience and expand our reach. Our other core innovations include:

Playlist Generating Algorithms. We have developed complex algorithms that determine which songs play and in what order on each personalized station. Developed since 2004, these algorithms combine the Music Genome Project with the individual and collective feedback we receive from our listeners in order to deliver a personalized listening experience.

Pandora User Experience. We have invested in ways to enable us to reach our audience anytime, anywhere that they enjoy music. To this end, we have developed a number of innovative approaches, including our autocomplete station creation feature, which predicts and generates a list of the most likely musical starting points as a listener begins to enter a favorite station, song or artist.

Pandora Mobile Streaming. We have designed a sophisticated system for streaming music content to mobile devices. This system involves a combination of music coding programs that are optimized for mobile devices as well as algorithms designed to address the intricacies of reliable delivery over diverse mobile network technologies. For example, these algorithms are designed to maintain a continuous stream to a listener even in circumstances where the mobile data network may be unreliable.

Automotive Protocol. We have developed an automotive protocol to facilitate increased availability of the Pandora service in automobiles. Through the automotive protocol, certain automobile manufacturers, their suppliers and makers of aftermarket audio systems can easily connect dash-mounted interface elements to the Pandora app running on a smartphone. This allows us to deliver the Pandora service to listeners via their existing smartphone, while leveraging the automobile itself for application command, display and control functionalities.

Pandora API. As part of our effort to make the Pandora service available everywhere our listeners want it, we have developed an application programming interface, which we call the Pandora API. Through our partnerships with manufacturers of consumer electronics products, we have used this technology to bring the Pandora experience to connected devices throughout the home.

Tv.pandora.com. We have developed a standards-based HTML5 website called tv.pandora.com that allows users to stream music content on next generation TV, game console and set top box architectures that support open web standards. Tv.pandora.com features streamlined navigation with controls and displays designed specifically for larger screens.

Distribution and Partnerships

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 traditional computers, we have developed Pandora mobile device applications or "apps" for smartphones such as 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, Pandora is now integrated with more than 1,000 connected devices, including automobiles, automotive aftermarket devices and consumer electronic devices.

Advertising Revenue

We derive the substantial majority of our revenue from the sale of audio, display and video advertising for delivery across our traditional computer-based, mobile and other connected device platforms. While historically our revenue growth was principally attributable to selling display advertising through our traditional computer-based platform, we now generate a majority of our revenue from mobile and other connected devices and our advertising includes a mix of audio, display and video. This expansion of our

services also presents an opportunity for us to reach our audience anytime, anywhere that they enjoy music, and therefore offer additional distribution channels to current and potential advertisers for delivery of their advertising messages.

Our advertising strategy focuses on developing our core suite of audio, display and video advertising products and marketing these products to advertisers for delivery across traditional computer and mobile and other connected device platforms. Our advertising products allow both local and national advertisers to target and connect with listeners based on attributes including age, gender, zip code and content preferences using multi-platform ad campaigns to target their advertising messages to listeners anytime and anywhere. As listenership on our mobile platforms has grown more rapidly than on our other platforms, we have sought to improve our advertising products for the mobile environment to better enable us to develop and market multi-platform advertising solutions. In the twelve months ended January 31, 2012 and 2013 and in the eleven months ended December 31, 2012 and 2013 advertising revenue accounted for approximately 87%, 88%, 88% (unaudited) and 82% of our total revenue, respectively, and we expect that advertising will comprise a substantial majority of revenue for the foreseeable future.

Audio Advertising. Our audio advertising products allow custom audio messages to be delivered between songs during short ad interludes. Audio ads are available across all of our delivery platforms. On supported platforms, the audio ads can be accompanied by display ads to further enhance advertisers' messages.

Display Advertising. Our display products offer advertisers opportunities to maximize exposure to our listeners through our desktop and mobile service interfaces, which are divided between our tuner containing our player and "now playing" information, and the information space surrounding our tuner. Our display ads include industry standard banner ads of various sizes and placements depending on platform and listener interaction.

Video Advertising. Our video advertising products allow delivery of rich branded messages to further engage listeners through in-banner click-initiated videos, videos that automatically play when a listener changes stations or skips a song and opt-in videos that pause the music and cover the tuner.

Our audio, display and video advertising products can be designed and modified by us and advertisers to create advertising campaigns tailored across all of our high volume delivery platforms to fit specific advertiser needs. For example, our advertisers can create custom "branded" stations from our music library that can be accessed by our listeners, as well as engage listeners by allowing them to personalize the branded stations through listener-controlled variables. Additionally, advertisers can also benefit from our proprietary ad targeting capabilities. Our proprietary targeting segments leverage listener-submitted profile information, enabling advertisers to precisely reach sought-after consumers across the web and connected devices without needing third-party cookies.

In 2013, we integrated Pandora's advertising inventory into the leading radio media buying platforms, Mediaocean and STRATA, and we are continuing to enhance the ability of radio advertisers to purchase media on these platforms which incorporate Triton measurements of our radio audience reach side-by-side with terrestrial radio metrics. In addition, we have invested in building a local sales force in major radio markets. In January 2014, we began rolling out in-car advertising solutions, which will run across the vehicle models that include a native Pandora integration. Our integration into standard radio media-buying processes and measurement, our in-car advertising solutions and our local ad sales force are key elements of our strategy for expanded penetration of the radio advertising market.

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. For the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013, subscription and other revenue accounted for 13%, 12%, 12% (unaudited) and 18% of our total revenue, respectively.

Content, Copyrights and Royalties

To secure the rights to stream music content over the internet, we must obtain licenses from, and pay royalties to, copyright owners of both sound recordings and musical works. These licensing and royalty arrangements strongly influence our business operations. We stream spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed without a specific license from any such performing rights organization or individual copyright owners. We do, however, obtain licenses to stream the sound recordings of comedy content under a federal statutory license, as described under the section captioned "Sound Recordings" below, which in some instances we have opted to augment with direct agreements with the licensors of such sound recordings.

Sound Recordings

The number of sound recordings we transmit to users of the Pandora service, as generally reflected by our listener hours, drives the vast 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. We obtain performance rights licenses and pay performance rights royalties for the benefit of the copyright owners of such sound recordings and the recording artists, both featured and non-featured, on such recordings, pursuant to the Digital Performance Right in Sound Recordings Act of 1995 (the "DPRA") and the Digital Millennium Copyright Act of 1998 (the "DMCA"). Under federal statutory licenses created by the DPRA and the DMCA, we are permitted to stream any lawfully released sound recordings and to make reproductions of these recordings on our computer servers, without having to separately negotiate and obtain direct licenses with each individual sound recording copyright owner. These statutory licenses are granted to us on the condition that we operate in compliance with the rules of the statutory licenses and pay the applicable royalty rates to SoundExchange, the non-profit organization designated by the Copyright Royalty Board, a tribunal established within the U.S. Library of Congress, or CRB, to collect and distribute royalties under these statutory licenses.

The rates we pay pursuant to these licenses can be established by either negotiation or through a rate proceeding conducted by the CRB. In 2009, certain webcasters reached a settlement agreement with SoundExchange establishing alternative rates and rate structures below those eventually established by the CRB for services not qualifying for the settlement rates. This settlement agreement is commonly known as the "Pureplay Settlement" that applies through 2015. We have elected since 2009 to avail ourselves of the Pureplay Settlement. Proceedings to establish rates that will be applicable to our service for the 2016-2020 period known as Webcasting IV proceedings, were commenced in January 2014. We are unable to estimate the direct and indirect costs of participating in the Webcaster IV proceedings, but we expect those costs to be significant. Further, federal copyright law does not recognize a public performance right for sound recordings created prior to February 15, 1972, and we face additional risks related to pre-1972 sound recording licensing. For additional details on risks related to the rate-setting process and pre-1972 sound recordings, please refer to the section entitled "Risk Factors."

The royalties we pay to SoundExchange for the streaming of sound recordings are calculated using a per performance rate and are subject to audit. The table below sets forth the per performance rates for the calendar years 2013 to 2015 as established by the CRB, which we have opted not to pay, under the Pureplay Settlement applicable to our non-subscription, ad-supported service and under the Pureplay Settlement applicable to our subscription service:

Year	CRB Rate	Pureplay Rate (non-subscription)*	Pureplay Rate (subscription)
2013	0.00210	0.00120	0.00220
2014	0.00230	0.00130	0.00230
2015	0.00230	0.00140	0.00250

* The rate applicable to our non-subscription service is the greater of the per performance rates set forth in this column or 25% of all of our U.S. gross revenue, including revenue from subscriptions.

As reflected in the table above, we pay per-performance rates for streaming of sound recordings via our Pandora One subscription service that are higher than the per-performance rates for our free, non-subscription service. As a result, we may incur higher royalty expenses to SoundExchange for a listener that subscribes to Pandora One as compared to a listener that uses our free, non-subscription service, even if both listeners listen to the same number of performers.

Musical Works

Our content costs are also comprised of the royalties we pay for the public performance of musical works embodied in the sound recordings that we stream. Copyright owners of musical works, typically, songwriters and music publishers, have traditionally relied on intermediaries known as performing rights organizations to negotiate so-called "blanket" licenses with copyright users, collect royalties under such licenses, and distribute them to copyright owners. We have obtained public performance licenses from, and pay license fees to, the three major performing rights organizations in the United States: the American Society of Composers, Authors and Publishers ("ASCAP"), Broadcast Music, Inc. ("BMI") and SESAC, Inc. ("SESAC").

We currently operate under an agreement with SESAC, which automatically renews yearly, but is subject to termination by either party in accordance with its terms at the end of each yearly term. The SESAC rate is subject to small annual increases.

We currently operate under interim licenses with each of ASCAP and BMI. ASCAP and BMI each are governed by a consent

decree with the United States Department of Justice. The rates we pay ASCAP and BMI can be established by either negotiation or through a rate court proceeding conducted by the United States District Court for the Southern District of New York. We elected to terminate our prior agreements with ASCAP as of December 31, 2010 and with BMI as of December 31, 2012 because, among other things, we believed that the royalty rates sought by ASCAP and BMI were in excess of rates paid by our largest radio competitors, broadcast radio stations and satellite radio. Notwithstanding our termination of these agreements, the musical works administered by each of ASCAP and BMI continued to be licensed to us pursuant to the provisions of their respective consent decrees. We are currently involved in rate court proceedings to determine the royalty rates we will pay to ASCAP and BMI. For additional details regarding such proceedings, please see the sections entitled “Risk Factors” and “Legal Proceedings.”

In some cases, we pay royalties directly to music publishers. Music publishers own or administer copyrights in musical works and license those copyrights to third parties that use music, such as record labels, filmmakers, television and radio stations. Publishers also collect license fees from these third parties and distribute the fees to the writers or composers of the musical works. Between 2012 and 2014, certain publishers purported to partially withdraw portions of their repertoires from each of ASCAP and BMI with the intent that each performing rights organization would be unable to license the withdrawn musical works to new media licensees such as Pandora. Our position is that attempted partial withdrawals violate the ASCAP and BMI consent decrees. From time to time, we have entered, and will continue to enter, into agreements with some purported withdrawing publishers to enable Pandora to continue to perform those publishers’ works amidst the current legal uncertainty. For additional details regarding such purported withdrawals, please see the sections entitled “Risk Factors” and “Legal Proceedings.”

Non-U.S. Licensing Regimes

In addition to the copyright and licensing arrangements described above for our use of sound recordings and musical compositions in the United States, other countries have various copyright and licensing regimes, including in some cases performing rights organizations and copyright collection societies from which licenses must be obtained. We have obtained licenses to operate in Australia and New Zealand for the communication of sound recordings and the musical compositions embodied in those sound recordings, which have not had a material effect on our results of operations to date.

Listening Limits

Until September 2011, for non-subscription listeners, we limited usage of our advertising-supported service on traditional, desktop and laptop, computers to 40 hours per month. Listeners who reached this limit could continue to use this service by paying \$0.99 for the remainder of the month. We included this revenue in subscription and other revenue. In September 2011, we effectively eliminated the 40 hour per month listening cap on traditional computers by increasing the cap to 320 hours of listening per month, which almost none of our listeners exceed.

In March 2013, we instituted a 40 hour per month listening limit for our advertising supported service on certain mobile and other connected devices. Listeners who reached this limit could continue to use our ad supported service on these devices by paying \$0.99 for the remainder of the month, could listen to our ad supported service on their traditional computers, or could purchase Pandora One annual subscriptions for \$36 per year or monthly subscriptions for \$4 per month. Effective September 2013, we eliminated this limit primarily due to our improved ability to monetize mobile listener hours. Although we have removed the broad 40 hour per month mobile listening limit, we have implemented other more precise measures that we believe will allow us to better manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience.

Government Regulation

As a company conducting business on the internet, we are subject to a number of foreign and domestic laws and regulations relating to consumer protection, information security and data protection, among other things. Many of these laws and regulations are still evolving and could be interpreted in ways that could harm our business. In the area of information security and data protection, the laws in several states require companies to implement specific information security controls to protect certain types of information. Likewise, all but a few states have laws in place requiring companies to notify users if there is a security breach that compromises certain categories of their information. We are also subject to federal and state laws regarding privacy of listener data, among other things. Our privacy policy and terms of use describe our practices concerning the use, transmission and disclosure of listener information and are posted on our website.

Sales and Marketing

We organize our sales force into multiple geographically-based teams that are each focused on selling advertising across our traditional computer, mobile and other connected device platforms. Teams are located in our Oakland, California headquarters, in

regional sales offices in Chicago, Illinois; Santa Monica, California; and New York, New York and local sales offices throughout the country and in Sydney, Australia.

Our marketing team is charged with amplifying Pandora's brand message to grow awareness and drive listener hours. We organize the marketing team into three groups focused on communications, marketing analytics and brand marketing.

Competition

Competition for Listeners

We compete for the time and attention of our listeners with other content providers on the basis of a number of factors, including quality of experience, relevance, acceptance and perception of content quality, ease of use, price, accessibility, perceptions of ad load, brand awareness and reputation. We also compete for listeners on the basis of our presence, branding and visibility as compared with other providers that deliver content through the internet, mobile devices and consumer products. We believe that we compete favorably on these factors. For additional details on risks related to competition for listeners, please refer to the section entitled "Risk Factors."

Many of our current and potential future competitors enjoy competitive advantages, such as greater name recognition, legacy operating histories and larger marketing budgets, as well as greater financial, technical and other resources. Our competitors include Apple, Spotify, Clear Channel, Slacker, Sirius XM, RDIO, Microsoft, Rhapsody, Google, Amazon, YouTube, Hulu and VEVO.

We compete for listeners with broadcast radio providers, including terrestrial radio providers. Many broadcast radio companies own large numbers of radio stations or other media properties. Many terrestrial radio stations have begun broadcasting digital signals, which provide high quality audio transmission. In addition, unlike participants in the emerging internet radio market, terrestrial and satellite radio providers, as aggregate entities of their subsidiary providers, generally enjoy larger established audiences and legacy operating histories. Broadcast and satellite radio companies enjoy a significant cost advantage because they pay a much lower percentage of revenue for transmissions of sound recordings. Broadcast radio pays no royalties for its terrestrial use of sound recordings, and satellite radio paid only 9.0% of revenue in 2013 and pays only 9.5% of revenue in 2014 for its satellite transmissions of sound recordings. By contrast, Pandora incurred content acquisition costs representing 48% of revenue for our internet transmissions of sound recordings during the eleven months ended December 31, 2013. We also compete directly with other emerging non-interactive internet radio providers, which may offer more extensive content libraries than we offer and some of which may be accessed internationally. We could face additional competition if known incumbents in the digital media space choose to enter the internet radio market.

We face competition from providers of interactive on-demand audio content and pre-recorded entertainment that allow listeners to select the audio content that they stream or purchase. This interactive on-demand content is accessible in automobiles and homes, using portable players, mobile phones and other wireless and consumer electronic devices. The audio entertainment marketplace continues to rapidly evolve, providing our listeners with a growing number of alternatives and new media platforms.

We compete for the time and attention of our listeners with providers of other forms of in-home and mobile entertainment. To the extent existing or potential listeners choose to watch cable television, stream video from on-demand services or play interactive video games on their home-entertainment system, computer or mobile phone rather than listen to the Pandora service, these content services pose a competitive threat.

Competition for Advertisers

We compete with other content providers for a share of our advertising customers' overall marketing budgets. We compete on the basis of a number of factors, including perceived return on investment, effectiveness and relevance of our advertising products, pricing structure and ability to deliver large volumes or precise types of ads to targeted demographics. We believe that our ability to deliver targeted and relevant ads across a wide range of platforms allows us to compete favorably on the basis of these factors and justify a long-term profitable pricing structure. However, the market for online advertising solutions is intensely competitive and rapidly changing, and with the introduction of new technologies and market entrants, we expect competition to intensify in the future. Our competitors include Facebook, Google, MSN, Yahoo!, ABC, CBS, FOX, NBC, The New York Times and the Wall Street Journal. For additional details on risks related to competition for advertisers, please refer to the section entitled "Risk Factors."

The market for online advertising is becoming increasingly competitive as advertisers are allocating increasing amounts of their overall marketing budgets to web-based advertising. We compete for online advertisers with other internet companies, including major internet portals, search engine companies and social media sites. Large internet companies with greater brand recognition have large direct sales staffs, substantial proprietary advertising technology and extensive web traffic and consequently enjoy significant

competitive advantages.

Terrestrial broadcast and to a lesser extent satellite radio are significant sources of competition for advertising dollars. These radio providers deliver ads across platforms that are more familiar to traditional advertisers than the internet might be. Advertisers may be reluctant to migrate advertising dollars to our internet-based platform.

We compete for advertising dollars with other traditional media companies in television and print. These traditional outlets present us with a number of competitive challenges in attracting advertisers, including large established audiences, longer operating histories, greater brand recognition and a growing presence on the internet.

Seasonality

Our results reflect the effects of seasonal trends in listener behavior due to higher advertising sales during the last three months of each calendar year due to greater advertiser demand during the holiday season and lower advertising sales in the first three months of the following calendar year due to reduced advertiser demand. In addition, we expect to experience increased usage during the last three months of each calendar year due to the holiday season, and in the first three months of each calendar year due to increased use of media-streaming devices received as gifts during the holiday season. We may also experience higher advertising sales during the last three months of each calendar year due to greater advertiser demand during the holiday season and lower advertising sales in the first three months of the calendar year due to reduced advertiser demand. See the section entitled "Business Trends" in Item 7 of this Transition Report on Form 10-K for a more complete description of the seasonality of our financial results.

The results of our prior fiscal quarters (three months ended April 30, July 31, October 31 and January 31 of each year prior to November 1, 2013) reflect the same effects of the seasonal trends on advertising revenue discussed above for calendar periods, except that the impact of these advertising sales-related trends on our fiscal results was not as pronounced due to the inclusion of January instead of October in our fourth fiscal quarter.

We changed our fiscal year to the calendar twelve months ended December 31 to align with the advertising industry's business cycle, effective beginning with the period ended on December 31, 2013. Due to this change, the effect of seasonality on our business will be more pronounced in calendar years ended after December 31, 2013.

Intellectual Property

Our success depends upon our ability to protect our technologies and intellectual property. To accomplish this, we rely on a combination of intellectual property rights, including trade secrets, patents, copyrights, trademarks, contractual restrictions, technological measures and other methods. We enter into confidentiality and proprietary rights agreements with our employees, consultants and business partners, and we control access to and distribution of our proprietary information.

We have 8 patents that have been issued in the United States and 10 that have been issued outside of the United States, and we continue to pursue additional patent protection, both in the United States and abroad where appropriate and cost effective. In June 2013, we purchased certain patents covering technologies used in internet radio from Yahoo! Inc. for \$8.0 million in cash. We intend to hold these patents as part of our strategy to protect and defend Pandora in patent-related litigation.

Our registered trademarks in the United States include "Pandora" and the "Music Genome Project," in addition to a number of Pandora logos. "Pandora" is also registered in Australia, Canada, Chile, the European Union, Israel, Korea, Mexico, New Zealand, Switzerland and other countries. "Music Genome Project" is also registered in Australia, China and New Zealand. We have pending trademark applications in the United States and in certain other countries, including applications for Pandora logos.

We are the registrant of the internet domain name for our website, pandora.com, as well as pandora.co.in, pandora.co.uk, pandora.co.nz and pandora.de, among others. We own rights to proprietary processes and trade secrets, including those underlying the Pandora service.

In addition to the foregoing protections, we generally control access to and use of our proprietary software and other confidential information through the use of internal and external controls, including contractual protections with employees, contractors, customers and partners.

Customer Concentration

For the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013 we had no customers that accounted for 10% or more of total revenue.

Employees

As of December 31, 2013, we had 1,069 employees. None of our employees are covered by collective bargaining agreements, and we consider our relations with our employees to be good.

Corporate and Available Information

We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010. Our principal executive offices are located at 2101 Webster Street, Suite 1650, Oakland, California 94612 and our telephone number is (510) 451-4100. Our website is located at www.pandora.com and our Investor Relations website is located at investor.pandora.com.

We changed our fiscal year to the calendar twelve months ending December 31 to align with the advertising industry's business cycle, effective beginning with the period ended on December 31, 2013. As a result, our current fiscal year was shortened from twelve months to an eleven-month transition period ended December 31, 2013. We reported our third fiscal quarter as the three months ended October 31, 2013, followed by a two-month transition period ended December 31, 2013.

In this Transition Report on Form 10-K, all references to a fiscal year prior to December 31, 2013 refer to the twelve months ended January 31 of such year, and references to the first, second, third and fourth fiscal quarters ended prior to November 1, 2013 refer to the three months ended April 30, July 31, October 31 and January 31, respectively.

We file reports with the Securities and Exchange Commission ("SEC"), including Annual and Transition Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any other filings required by the SEC. We make available on our Investor Relations website, free of charge, our Annual and Transition Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information on our website is not incorporated by reference into this Transition Report on Form 10-K or in any other report or document we file with the SEC.

The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

ITEM 1A. RISK FACTORS

The risks and uncertainties set forth below, as well as other factors described elsewhere in this Transition Report on Form 10-K or in other filings by us with the SEC, could adversely affect our business, financial condition, results of operations and the trading price of our common stock. Additional risks and uncertainties that are not currently known to us or that are not currently believed by us to be material may also harm our business operations and financial results. Because of the following factors, as well as other factors affecting our financial condition and operating results, past financial performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Risks Related to Our Business

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

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

- our relatively new, evolving and unproven business model;
- our ability to retain our current listenership, build our listener base and increase listener hours;
- our ability to effectively monetize listener hours, particularly with respect to listener hours on mobile devices, by growing our sales of advertising inventory created from growing listener hours and developing compelling ad product solutions that successfully deliver advertisers' messages across the range of our delivery platforms while maintaining our listener experience in continually evolving markets;
- our ability to attract new advertisers, retain existing advertisers and prove to advertisers that our advertising platform is effective enough to justify a pricing structure that is profitable for us;
- our ability to maintain relationships with makers of mobile devices, consumer electronic products and automobiles;
- our operation under an evolving music industry licensing structure including statutory and consent decree licenses that may change or cease to exist, which in turn may result in a significant increase in our operating expenses; and
- our ability to continue to secure the rights to music that attracts listeners to the service on fair and reasonable economic terms.

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

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

Since our inception in 2000, we have incurred significant net operating losses and, as of December 31, 2013, we had an accumulated deficit of \$166.6 million. A key element of our strategy is to increase the number of listeners and listener hours to increase our market penetration, including the number of listener hours on mobile and other connected devices. However, as our number of listener hours increases, the royalties we pay for content acquisition also increase. In addition, we have adopted a strategy to invest in our operations in advance of, and to drive, future revenue growth. As a result of these trends, we have not in the past generated, and may not in the future generate, sufficient revenue from the sale of advertising and subscriptions to offset our expenses.

If we cannot successfully earn revenue at a rate that exceeds the operational costs associated with increased listener hours, we may not be able to achieve or sustain profitability. In addition, we expect to invest heavily in our operations to support anticipated future growth. As a result of these factors, we expect to incur annual net losses on a U.S. GAAP basis in the near term.

Our revenue increased rapidly in each of the twelve months ended January 31, 2007 through January 31, 2013, and the eleven months ended December 31, 2013; however, we do not expect to sustain our high revenue growth rates in the future as a result of a variety of factors, including increased competition and the maturation of our business, and we cannot assure you that our revenue will continue to grow or will not decline. You should not consider our historical revenue growth or operating expenses as indicative of our future performance. If revenue growth is lower than our expectations, or our operating expenses exceed our expectations, our financial performance will be adversely affected. Further, if our future growth and operating performance fail to meet investor or analyst expectations, it could have a materially negative effect on our stock price.

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

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

For the eleven months ended December 31, 2013 we derived 82% of our revenue from the sale of advertising and expect to continue to derive a substantial majority of our revenue from the sale of advertising in the future. Our ability to attract and retain advertisers, and ultimately to sell our advertising inventory to generate advertising revenue, depends on a number of factors, including:

- increasing the number of listener hours;
- keeping pace with changes in technology and our competitors;
- competing effectively for advertising dollars from other online marketing and media companies;
- penetrating the market for local radio advertising;
- demonstrating the value of advertisements to reach targeted audiences across all of our delivery platforms, including the value of mobile digital advertising;
- continuing to develop and diversify our advertising platform, which currently includes delivery of display, audio and video advertising products through multiple delivery channels, including traditional computers, mobile and other connected devices; and
- coping with ad blocking technologies that have been developed and are likely to continue to be developed that can block the display of our ads.

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

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

Our number of listener hours on mobile devices has surpassed listener hours on traditional computers, and we expect that this trend will continue. Our mobile listenership has experienced significant growth since we introduced the first mobile version of our service in May 2007. Listener hours on mobile and other connected devices constituted approximately 54%, 69%, 77% and 80% of our total listener hours for the twelve months ended January 31, 2011, 2012 and 2013 and for the eleven months ended December 31, 2013, respectively. We expect this shift towards mobile to continue, though at a less rapid pace. Digital advertising on mobile devices is an emerging phenomenon, and the percentage of advertising spending allocated to digital advertising on mobile devices is lower than that allocated to traditional online advertising. According to IDC, the percentage of U.S. advertising spending allocated to advertising on mobile devices was less than 1% in 2010, compared to 13% for all online advertising. We must therefore convince advertisers of the capabilities of mobile digital advertising opportunities so that they migrate their advertising spend toward

demographics and ad solutions that more effectively utilize mobile inventory.

We are still at an early stage of building our sales capability to penetrate local advertising markets, which we view as a key challenge in monetizing our listener hours, including listener hours on mobile and other connected devices. In addition, while a substantial amount of our revenue has traditionally been derived from display ads, some display ads may not be currently optimized for use on certain mobile or other connected devices. For example, standard display ads may not be well-suited for use on smartphones due to the size of the device screen and may not be appropriate for smartphones connected to or integrated in automobiles due to safety considerations. Further, some display ads may not be optimized to take advantage of the multimedia capabilities of connected devices. By contrast, audio ads are better-suited for delivery on smartphones connected to or installed in automobiles and across mobile and connected device platforms and video ads can be optimized for a variety of platforms. However, our audio and video advertising products are relatively new and have not been as widely accepted by advertisers as our traditional display ads. In addition, the introduction of audio advertising places us in more direct competition with terrestrial radio, as many advertisers that purchase audio ads focus their spending on terrestrial radio stations who traditionally have strong connections with local advertisers.

We have plans that, if successfully implemented, would increase our number of listener hours on mobile and other connected devices, including efforts to expand the reach of our service by making it available on an increasing number of devices, such as smartphones and devices connected to or installed in automobiles. In order to effectively monetize such increased listener hours, we must, among other things, convince advertisers to migrate spending to nascent advertising markets, penetrate local advertising markets and develop compelling ad product solutions. We cannot assure you that we will be able to effectively monetize inventory generated by listeners using mobile and connected devices, or the time frame on which we may do so.

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

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

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

- providing listeners with a consistent high quality, user-friendly and personalized experience;
- continuing to build our catalogs of music and comedy content that our listeners enjoy;
- continuing to innovate and keep pace with changes in technology and our competitors;
- maintaining and building our relationships with makers of consumer products such as mobile devices, other consumer electronic products and automobiles to make our service available through their products; and
- maintaining positive listener perception of our service while managing ad-load to optimize inventory utilization;

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

Further, although we use our number of registered users and our number of active users as indicators of our brand awareness and the growth of our business, the number of registered users and number of active users exceeds the number of unique individuals

who register for, or actively use, our service. We define registered users as the total number of accounts that have been created for our service and we define active users as the number of distinct registered users that have requested audio from our servers within the trailing 30 days from the end of each calendar month. To establish an account, a person does not need to provide personally unique information. For this reason a person may have multiple accounts. If the number of actual listeners does not result in an increase in listener hours, then our business may not grow as quickly as we expect, which may harm our business, operating results and financial condition.

We have experienced rapid growth in both listener hours and advertising revenue. We do not expect to be able to sustain these growth rates in the future and our business and operating results may suffer.

We have experienced rapid growth rates in both listener hours and advertising revenue as a result of our growth strategy to commit substantial financial, operational and technical resources to build the Company. As we grow larger and increase our listener base and usage, we expect it will become increasingly difficult to maintain the rate of growth we currently experience. Slower growth could negatively impact our stock price, our ability to hire and retain employees or harm our business in other ways.

If our efforts to attract and retain subscribers are not successful, our business may be adversely affected.

In the eleven months ended December 31, 2013, subscription revenue comprised 18% of our total revenue, compared to 12% (unaudited) in the eleven months ended December 31, 2012. The growth in subscribers and subscription revenue in the transition period ended December 31, 2013 has been driven substantially by the listener hour limit we instituted on mobile listeners in March 2013. In September 2013, we removed the mobile listening limit, due to other tools that we have instituted to moderate mobile listener hour growth. As a result, we do not expect the growth rate we experienced in subscribers in the eleven months ended December 31, 2013 to continue. Furthermore, listeners who subscribed to Pandora One in response to the mobile listening limit may choose to cancel their subscriptions going forward and return to using our free, ad-supported service. As a result, we presently expect subscriber growth to be lower than in corresponding prior year periods for the near term. Over the longer term, our ability to continue to attract subscribers will depend in part on our ability to consistently provide our subscribers with a quality experience through Pandora One. If Pandora One subscribers do not perceive that offering to be of value, or if we introduce new or adjust existing features or pricing in a manner that is not favorably received by them, we may not be able to attract and retain subscribers. Subscribers may cancel their subscription to our service for many reasons, including a perception that they do not use the service sufficiently, the need to cut household expenses, competitive services provide a better value or experience or as a result in changes in pricing, if any. If our efforts to attract and retain subscribers are not successful, our business, operating results and financial condition may be adversely affected.

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

We believe that a key differentiating factor between the Pandora service and other music content providers is our ability to predict music that our listeners will enjoy. Our personalized playlist generating system, based on the Music Genome Project and our proprietary algorithms, is designed to enable us to predict listener music preferences and select music content tailored to our listeners' individual music tastes. We have invested, and will continue to invest, significant resources in refining these technologies; however, we cannot assure you that such investments will yield an attractive return or that such refinements will be effective. The effectiveness of our personalized playlist generating system depends in part on our ability to gather and effectively analyze large amounts of listener data and listener feedback and we have no assurance that we will continue to be successful in enticing listeners to give a thumbs-up or thumbs-down to enough songs for our database to effectively predict and select new and existing songs. In addition, our ability to offer listeners songs that they have not previously heard and impart a sense of discovery depends on our ability to acquire and appropriately categorize additional tracks that will appeal to our listeners' diverse and changing tastes. While we have more than 1,000,000 songs in our catalog, we must continuously identify and analyze additional tracks that our listeners will enjoy and we may not effectively do so. Further, many of our competitors currently have larger catalogs than we offer and they may be more effective in providing their listeners with a more appealing listener experience.

We also provide comedy content on Pandora, an offering that is designed to predict what our listeners will enjoy using technology similar to the technology that we use to generate personalized playlists for music. The risks that apply to predicting our listeners' musical tastes apply to comedy to an even greater extent, particularly as we lack experience with content other than music, do not yet have as large a set of data on listener preferences for comedy and have a much smaller comedy catalog as compared to music. Our ability to predict and select music or comedy content that our listeners enjoy is critical to the perceived value of our service among listeners and failure to make accurate predictions would adversely affect our ability to attract and retain listeners, increase listener hours and sell advertising.

If we fail to effectively manage our growth, our business and operating results may suffer.

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

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

We compete with other content providers for listeners.

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

Many of our competitors may leverage their existing infrastructure, brand recognition and content collections to augment their services by offering competing internet radio features to provide listeners with more comprehensive music service delivery choices. We face increasing competition for listeners from a growing variety of businesses that deliver audio media content through mobile phones and other wireless devices. Our competitors include Apple, Spotify, Clear Channel, Slacker, Sirius XM, RDIO, Microsoft, Rhapsody, Google, Amazon, YouTube, Hulu and VEVO.

Our competitors include terrestrial radio, satellite radio and internet radio. Terrestrial radio providers offer their content for free, are well-established and accessible to listeners and offer content, such as news, sports, traffic, weather and talk that we currently do not offer. In addition, many terrestrial radio stations have begun broadcasting digital signals, which provide high-quality audio transmission. Satellite radio providers may offer extensive and oftentimes exclusive news, comedy, sports and talk content, national signal coverage and long-established automobile integration. In addition, terrestrial radio pays no royalties for its use of sound recordings and satellite radio pays a much lower percentage of revenue, 9.0% in 2013 and 9.5% in 2014, than internet radio providers for use of sound recordings, giving broadcast and satellite radio companies a significant cost advantage. We also compete directly with other emerging non-interactive internet radio providers, which may offer more extensive content libraries than we offer and some of which may be accessed internationally.

On-demand audio media and entertainment which are purchased or available for free and playable on mobile devices, automobiles and in the home provide listeners with an interactive experience. These forms of media may be purchased, downloaded and owned such as iTunes audio files, MP3s, CDs, or accessed from subscription or free online on-demand offerings by music providers.

We compete for the time and attention of our listeners with providers of other forms of in-home and mobile entertainment. To the extent existing or potential listeners choose to watch cable television, stream video from on-demand services or play interactive video games on their home-entertainment system, computer or mobile phone rather than listen to the Pandora service, these content services pose a competitive threat.

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

both domestic and international, in which we compete.

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

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

We compete for advertising spending with other content providers.

We compete for a share of advertisers' overall marketing budgets with other content providers on a variety of factors including perceived return on investment, effectiveness and relevance of our advertising products, pricing structure and ability to deliver large volumes or precise types of ads to targeted demographics. Our competitors include Facebook, Google, MSN, Yahoo!, ABC, CBS, FOX, NBC, The New York Times and the Wall Street Journal.

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

We also face significant competition for advertising dollars from terrestrial and, to a lesser extent, satellite radio providers. As many of the advertisers we target have traditionally advertised on terrestrial radio and have less experience with internet radio providers, they may be reluctant to spend for advertising on traditional computers, mobile or other connected device platforms.

In addition, terrestrial radio providers as well as other traditional media companies in television and print, cable television channel providers, national newspapers and some regional newspapers enjoy a number of competitive advantages over us in attracting advertisers, including large established audiences, longer operating histories, greater brand recognition and a growing presence on the internet.

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

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

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

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

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

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

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

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

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

Selling ads, locally and nationally, requires that we demonstrate to advertisers that our service has substantial reach and usage. Third-party measurements may not reflect our true listening audience and their underlying methodologies are subject to change at any time. In addition, the methodologies we apply to measure the key metrics that we use to monitor and manage our business may differ from the methodologies used by third-party measurement service providers. For example, 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. By contrast, certain third-party measurement service providers may calculate and report the number of listener hours using a client-based approach, which measures time elapsed during listening sessions. Measurement technologies for mobile and consumer electronic devices may be even less reliable in quantifying the reach and usage of

our service, and it is not clear whether such technologies will integrate with our systems or uniformly and comprehensively reflect the reach and usage of our service. While we have been working with third-party measurement service providers, these providers have not yet developed uniform measurement systems that comprehensively measure the reach and usage of our service. In order to demonstrate to potential advertisers the benefits of our service, we must supplement third-party measurement data with our internal research, which may be perceived as less valuable than third-party numbers. If such third-party measurement providers report lower metrics than we do, or if there is wide variance among reported metrics, our ability to convince advertisers of the benefits of our service could be adversely affected.

The lack of accurate cross-platform measurements for internet radio and broadcast radio may adversely affect our ability to grow advertising revenue.

Pandora has invested substantial resources to create accurate cross-platform measurements for internet radio and broadcast radio in the major automated media-buying platforms, creating a one-stop shop that enables media buyers to compare internet radio audience reach with terrestrial radio audience reach using traditional broadcast radio metrics. To achieve this result, we currently rely on third parties such as Triton to quantify the reach and usage of our service and on media buying companies to provide Internet radio metrics side-by-side with terrestrial radio metrics in media-buying platforms.

We have also partnered with media buying companies that show internet radio measurements alongside terrestrial metrics in the media buying systems that media buyers use to purchase advertising. Media buying companies receive measurement metrics from third parties, such as Triton for internet radio and Arbitron and Nielsen for more traditional media like terrestrial radio and television. Media buying companies may choose not to show, or may be prohibited by third-party measurement services that measure terrestrial radio and other traditional media from showing, internet radio metrics alongside traditional terrestrial metrics. Our ability to realize our long-term potential will be significantly affected by our success in these advertising initiatives, and there is no assurance we will achieve substantial penetration of these advertising markets.

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

The percentage of the advertising market allocated to online advertising lags the percentage of consumer online consumption by a significant degree. Growth of our business will depend in large part on the reduction or elimination of this gap between online and offline advertising spending, which may not happen in a way or to the extent that we currently expect. Many advertisers still have limited experience with online advertising and may continue to devote significant portions of their advertising budgets to traditional, offline advertising media. Accordingly, we continue to compete for advertising dollars with traditional media, including broadcast radio. We believe that the continued growth and acceptance of our online advertising products will depend on the perceived effectiveness and the acceptance of online advertising models generally, which is outside of our control. Any lack of growth in the market for online advertising could result in reduced revenue or increased marketing expenses, which would harm our operating results and financial condition.

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

We currently operate under statutory licenses that may change or cease to exist. We must pay performance rights royalties for the digital audio transmission of sound recordings. Subject to our ongoing compliance with numerous statutory conditions and regulatory requirements for a non-interactive service, we are permitted to operate our radio service under federal statutory licenses that allow the streaming in the U.S. of any sound recording lawfully released to the public. The service does have a small number of interactive components for which we obtain licenses directly from the rights holders, but we believe that these components do not impact our status as a non-interactive service. We are also permitted to make reproductions of sound recordings on computer servers pursuant to these statutory licenses designed to facilitate the making of transmissions. There is no guarantee that Congress will not amend the Copyright Act to eliminate the availability of these licenses or that we will continue to be eligible to operate under these statutory licenses. For example, if copyright owners objected, and a court agreed, that we operate an “interactive” streaming service, that we make reproductions of sound recordings not covered by the statutory license, or that the functionality or transmission methods of our service extend beyond what is allowed under the statutory license, we could be subject to significant liability for copyright infringement and, absent making technological changes, lose our eligibility to operate under the statutory license. In that event, we would have to negotiate license agreements with sound recording copyright owners individually, a time-consuming and expensive undertaking that could jeopardize our ability to stream a significant percentage of the music currently in our library and result in royalty costs that are prohibitively expensive. For the eleven months ended December 31, 2013 we incurred SoundExchange related content acquisition costs representing 48% of our total revenue for that period.

As described in “Business–Content, Copyrights and Royalties–Sound Recordings”, we currently elect to avail ourselves of the Pureplay Settlement, which provides of rates and terms of statutory licenses for the reproduction and public performance of sound recordings for commercial webcasters through 2015, and we intend to continue to avail ourselves of this settlement through 2015. We presently do not know what rates will be available to us commencing January 1, 2016. There can be no assurance that we will be able to reach a new agreement with SoundExchange for rates for commercially reasonable rates. The CRB, which still has rate-making authority over us upon expiration of the Pureplay Settlement, has consistently established royalty rates, including those established for the years 2011 through 2015 that would, if paid by us, consume a significantly greater portion of our revenue and negatively impact our ability to achieve and sustain profitability. There can be no assurance that the per performance rates established by the CRB for periods following 2015 will not exceed the rates currently paid by us under the Pureplay Settlement. If we are unable to reach a new agreement for commercially reasonable rates with SoundExchange and the CRB sets performance rates for post-2015 periods that exceed the Pureplay Settlement, our content acquisition costs may significantly increase, which could materially harm our financial condition and inhibit the implementation of our business plans.

We depend upon third-party licenses for the right to publicly perform musical works and a change to these licenses could materially increase our content acquisition costs.

Our content costs, in part, are comprised of the royalties we pay for the public performance of musical works embodied in the sound recordings that we stream. As described in “Business–Content, Copyrights and Royalties–Musical Works” to secure the rights to publicly perform musical works embodied in sound recordings over the internet, we obtain licenses from or for the benefit of copyright owners and pay royalties to copyright owners or their agents. Copyright owners of musical works are vigilant in protecting their rights and currently are seeking substantial increases in the rates applicable to the public performance of such works. There is no guarantee that the licenses available to us now will continue to be available in the future or that such licenses will be available at the royalty rates associated with the current licenses. If we are unable to secure and maintain rights to publicly perform musical works or if we cannot do so on terms that are acceptable to us, our ability to perform music content to our listeners, and consequently our ability to attract and retain both listeners and advertisers, will be adversely impacted.

Copyright owners of musical works, typically, songwriters and music publishers, have traditionally relied on intermediaries known as performing rights organizations to negotiate so-called “blanket” licenses with copyright users, collect royalties under such licenses, and distribute them to copyright owners. We have obtained public performance licenses from, and pay license fees to, the three major performing rights organizations in the United States: the American Society of Composers, Authors and Publishers (“ASCAP”), Broadcast Music, Inc. (“BMI”) and SESAC, Inc. (“SESAC”).

We currently operate under an agreement with SESAC, which automatically renews yearly, but is subject to termination by either party in accordance with its terms at the end of each yearly term. The SESAC rate is subject to small annual increases. There is no guarantee that either the license or the associated royalty rate available to us now with respect to SESAC will be available to us in the future.

We currently operate under interim licenses with each of ASCAP and BMI. ASCAP and BMI each are governed by a consent decree with the United States Department of Justice. The rates we pay ASCAP and BMI can be established by either negotiation or through a rate court proceeding conducted by the United States District Court for the Southern District of New York. We elected to terminate our prior agreements with ASCAP as of December 31, 2010 and with BMI as of December 31, 2012 because, among other things, we believed that the royalty rates sought by ASCAP and BMI were in excess of rates paid by our largest radio competitors, broadcast radio stations and satellite radio. Notwithstanding our termination of these agreements, the musical works administered by each of ASCAP and BMI continued to be licensed to us pursuant to the provisions of their respective consent decrees. In November 2012, we filed a petition requesting that the ASCAP rate court determine reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. In June 2013, BMI filed a petition requesting that the BMI rate court determine reasonable license fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2017. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014. A trial date has not been set for the BMI rate court proceeding. Each of these proceedings has been, and is expected to continue to be, protracted, expensive and uncertain in outcome. It is likely that trial level outcomes will be appealed and the final resolution may not be known for years. In the event that these matters are resolved adversely to us, our content acquisition costs could increase significantly, which would adversely affect our operating results. There is no guarantee that final rates established by mutual agreement or by a rate court determination would establish royalty rates more favorable to us than those we previously paid pursuant our terminated agreements with ASCAP and/or BMI or those that we pay pursuant to our interim arrangements with ASCAP and/or BMI. For the eleven months ended December 31, 2013, we incurred content acquisition costs for the public performance of musical works representing 4% of our total revenue for that period.

We do not currently pay so-called "mechanical royalties" to music publishers for the reproduction and distribution of musical works embodied in server copies or transitory copies used to make streams audible to our listeners. Although not currently a matter of dispute, if music publishers were to retreat from the publicly stated position of their trade association that non-interactive streaming does not require the payment of a mechanical royalties, and a final judgment were entered by a court requiring that payment, our royalty obligations could increase significantly, which would increase our operating expenses and harm our business and financial interests. While we would vigorously challenge such mechanical royalties as not required by law, our challenge may be unsuccessful and would in any case involve commitment of substantial time and resources. In addition, we stream spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization in the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization or individual rights owners, although royalties are paid to SoundExchange for the public performance of the sound recordings in which such literary works are embodied. There can be no assurance that this industry custom will not change or that we will not otherwise become subject to additional licensing costs for spoken word comedy content imposed by performing rights organizations or individual copyright owners in the future or be subject to damages for copyright infringement.

Changes in third-party licenses for the right to publicly perform musical works may reduce the sound recordings that we perform on the service or materially increase our content acquisition costs.

The number of works administered by SESAC, ASCAP and BMI may fluctuate over time and may be subject to the withdrawal of certain rights by individual SESAC, ASCAP and BMI-affiliated music publishers for certain types of transmissions by certain types of services, such as Pandora, or the loss of repertory entirely in the event of a publisher's complete withdrawal from any of SESAC, ASCAP or BMI. The decrease in the works licensed by SESAC, ASCAP and BMI may require more direct licensing by Pandora with individual music publishers and individual publishers not subject to a mandatory licensing obligations who could withhold the rights to all of the musical works which they own or administer. Between 2012 and 2014, certain publishers purported to partially withdraw portions of their repertoires from each of ASCAP and BMI with the intent that each performing rights organization would be unable to license the withdrawn musical works to new media licensees such as Pandora. Our position is that these attempted partial withdrawals were a violation of the ASCAP and BMI consent decrees, and we moved for summary judgment in both the ASCAP and BMI rate courts to clarify the issue.

The ASCAP rate court granted our summary motion in September 2013, which is subject to appeal, determining that the publishers' attempted partial withdrawals from ASCAP would place ASCAP in violation of its consent decree and, therefore, were ineffectual. The BMI rate court agreed that the attempted partial withdrawals would place BMI in violation of its consent decree; however, it also determined that any publisher seeking to partially withdraw from BMI would be deemed to have totally withdrawn from BMI. Based on the ASCAP court decision, we believe that Pandora remains able to perform works that were the subject of such attempted partial withdrawals. Based on the recent BMI court decision, however, there is some doubt regarding our immediate ability under the BMI license to perform works that have been the subject of attempted partial publisher withdrawals. From time to time, in light of the legal uncertainties, we have entered into agreements with some purported withdrawing publishers to enable Pandora to continue to perform those publishers' works while we continue to pursue other legal remedies.

If music publishers effectuate withdrawals of all or a portion of their catalogs from ASCAP, BMI or SESAC, we may no longer be able to obtain licenses for such publisher's withdrawn catalogs from ASCAP, BMI or SESAC. Under these circumstances, we would either need to enter into direct licensing arrangements with such music publishers or remove those musical works from the service, including any sound recordings in which such musical works are embodied. Although we continue to be licensed by the performing rights organizations, it is unclear what specific effect a publisher's purported limited or prospective complete withdrawal of rights to public performances by means of digital transmissions from a performing rights organization would have on us. If we are unable to reach an agreement with respect to the repertoire of any music publisher which successfully withdraws all or a portion of its catalog(s) from a performing rights organization, or if we are forced to enter into direct licensing agreements with such publishers at rates higher than those currently set by the performing rights organizations, or higher than those set by the U.S. District Court having supervisory authority over ASCAP and BMI, for the performance of musical works, or if there is uncertainty as to what rights are administered by any particular performing rights organization or publisher, the number of sound recordings that we perform on our service may be reduced, our content acquisition costs may increase and our ability to retain and expand our listener base could be adversely affected, any of which could adversely affect our business, financial condition and results of operations.

Assertions by third parties of violations under state law with respect to the public performance and reproduction of pre-1972 sound recordings could result in significant costs and substantially harm our business and operating results.

As described in "Business-Content, Copyrights and Royalties-Sound Recordings", sound recordings made on or after February 15, 1972 fall within the scope of federal copyright protection. Subject to our ongoing compliance with numerous federal

statutory conditions and regulatory requirements for a noninteractive service, we are permitted to operate our radio service under a statutory license that allows the streaming in the U.S. of any such sound recording lawfully released to the public and permits us to make reproductions of such sound recordings on computer servers pursuant to a separate statutory license designed to facilitate the making of such transmissions.

By contrast, protection of sound recordings created prior to February 15, 1972 ("pre-1972 sound recordings") remains governed by a patchwork of state statutory and common laws. Copyright owners of pre-1972 sound recordings have commenced litigation against Sirius XM Radio Inc., alleging violations of numerous state statutory and common laws with respect to the unauthorized reproduction and public performance of pre-1972 sound recordings, seeking, among other things, restitution, disgorgement of profits, exemplary and punitive damages as well as injunctive relief prohibiting further violation of those copyright owners' alleged exclusive rights. Similar litigation could be brought against us for similar claims. If we are sued and found liable for the violation of the exclusive rights of any pre-1972 sound recording copyright owners, then we could be subject to liability, the amount of which could be significant. If we are required to obtain licenses from individual sound recording copyright owners for the reproduction and public performance of pre-1972 sound recordings, then the time, effort and cost of securing such licenses directly from all owners of sound recording used on our service could be significant and could harm our business and operating results. If we are required to obtain licenses for pre-1972 sound recordings to avoid liability and are unable to secure such licenses, then we may have to remove pre-1972 sound recordings from our service, which could harm our ability to attract and retain users.

Our royalty payments are subject to audits and our royalty calculation methods involve significant estimates.

The royalties that we pay to SoundExchange for the streaming of sound recordings are calculated using a per performance rate. While we believe that the mechanisms we use to track performances are sufficient to ensure that we are accurately reporting and paying royalties, our ability to do so depends in part on our ability to maintain these mechanisms as new devices are introduced and technologies evolve. Any understatement or overstatement of performances could result in our paying lower or higher royalties to SoundExchange than we actually owed, which could in turn affect our financial condition and results of operations. SoundExchange has the right to audit our royalty payments and in December 2013 informed us that it intends to audit our payments for the years 2010, 2011, and 2012. In addition, performing rights organizations and musical work copyright owners with whom we have entered into direct licenses have or may have the right to audit our royalty payments, and any such audit could result in disputes over whether we have paid the proper royalties. If such a dispute were to occur, we could be required to pay additional royalties and audit fees. The amounts involved could be material.

Rate court proceedings, the attempted and/or purported withdrawal of certain music publishers or the rights to certain of their works for certain purposes from ASCAP and BMI, and our recent entry into a local marketing agreement to program KXMZ-FM have highlighted uncertainties for the royalty rates that we pay for the public performance of musical works. For example, we could be liable for both increased royalty rates going forward and a potential true-up of royalty payments in excess of any interim royalties paid for the period following December 31, 2010 with respect to ASCAP and/or for the period following December 31, 2012 with respect to BMI. We record a liability for public performance royalties based on our best estimate of the amount owed to each organization based on historical rates, third-party evidence and legal developments. For each quarterly period, we evaluate our estimates to assess the adequacy of recorded liabilities. If actual royalty rates differ from estimates, revisions to the estimated royalty liabilities may be required, which could materially affect our results of operations. Any royalty audit could result in disputes over whether we have paid the proper royalties.

Our inability to obtain accurate and comprehensive information to identify the ownership of a musical work may impact our ability to remove musical works or decrease the number of performances of a particular musical work, subjecting us to potential copyright infringement and difficulties in controlling content acquisition costs.

Comprehensive and accurate rightsholder information for the musical works that we publicly perform is not presently available. Without the ability to identify which composers, songwriters or publishers own or administer musical works, it may be difficult to remove from our service musical works for which we have not obtained a license, which may subject us to significant liability for copyright infringement.

In addition, we have historically relied on the provisions of blanket licenses from ASCAP and BMI pursuant to certain consent decrees, and if the consent decrees no longer provide for such blanket licenses, our lack of ownership information for the musical works we stream may make it difficult to identify the appropriate rightsholders from which to obtain a license, which could also lead to a reduction of musical works performed on our service, adversely impacting our ability to retain and expand our listener base.

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

Expansion of our operations into delivery of non-music content stations involves numerous risks and challenges, including increased capital requirements, new competitors and the need to develop new strategic relationships. Growth into this new area may require changes to our existing business model and cost structure, modifications to our infrastructure and exposure to new regulatory and legal risks, including infringement liability, any of which may require expertise in which we have little or no experience. There is no guarantee that we will be able to generate sufficient revenue from advertising sales associated with comedy content to offset the costs of maintaining comedy stations or the royalties paid for such comedy stations. Further, we have established a reputation as an online music provider and our ability to gain acceptance and listenership for comedy content stations, and thus our ability to attract advertisers on comedy stations, is not certain. Failure to obtain or retain rights to comedy content on acceptable terms, or at all, to successfully monetize and generate revenues from such content, or to effectively manage the numerous risks and challenges associated with such expansion could adversely affect our revenues and profitability. To the extent we choose, in the future, to offer additional types of content beyond music and comedy, such as news, talk and sports programming, we will be subject to many of these same risks.

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

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

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

We use DoubleClick's ad-serving platform to deliver and monitor ads for our service. There can be no assurance that our agreement with DoubleClick, which is owned by Google, will be extended or renewed upon expiration, that we will be able to extend or renew our agreement with DoubleClick on terms and conditions favorable to us or that we could identify another alternative vendor to take its place. Our agreement with DoubleClick also allows DoubleClick to terminate our relationship before the expiration of the agreement on the occurrence of certain events, including material breach of the agreement by us, and to suspend provision of the services if DoubleClick determines that our use of its service violates certain security, technology or content standards.

If we are unable to implement and maintain effective internal control over financial reporting in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to furnish a report by our management on our internal control over financial reporting. The report contains, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of year-end, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

While we have determined that our internal control over financial reporting was effective as of December 31, 2013, as indicated in our Management's Annual Report on Internal Control over Financial Reporting included in this Transition Report on Form 10-K for the eleven months ended December 31, 2013, we must continue to monitor and assess our internal control over financial reporting. If our management identifies one or more material weaknesses in our internal control over financial reporting and such weakness remains uncorrected at year-end, we will be unable to assert such internal control is effective at year-end. If we are unable to assert that our internal control over financial reporting is effective at year-end, or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls or concludes that we have a material weakness in our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have a material adverse effect on our business and price of our common stock.

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

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

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

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

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

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

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

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

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

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

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

- our ability to retain our current listenership, build our listener base and increase listener hours;
- our ability to more effectively monetize mobile listener hours by increasing the sale of mobile advertising inventory as the number of listener hours on mobile devices grow;
- our ability to attract and retain existing advertisers and prove that our advertising products are effective enough to justify a pricing structure that is profitable for us;
- our ability to effectively manage our growth;
- our ability to secure licenses for sound recordings and musical works on favorable terms;
- the effects of increased competition in our business;
- our ability to keep pace with changes in technology and our competitors;
- interruptions in service, whether or not we are responsible for such interruptions, and any related impact on our reputation;
- costs associated with defending any litigation, including intellectual property infringement litigation;
- our ability to pursue, and the timing of, entry into new geographic or content markets and, if pursued, our management of this expansion;
- the impact of general economic conditions on our revenue and expenses; and
- changes in government regulation affecting our business.

Seasonal variations in listener and advertising behavior may also cause fluctuations in our financial results. We expect to experience some effects of seasonal trends in listener behavior due to higher advertising sales during the fourth quarter of each calendar year due to greater advertiser demand during the holiday season and lower advertising sales in the first three months of the following calendar year due to reduced advertiser demand. 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. In addition, we expect to experience increased usage during the fourth quarter of each calendar year due to the holiday season, and in the first quarter of each calendar year due to increased use of media-streaming devices received as gifts during the holiday season. While we believe these seasonal trends have affected and will continue to affect our quarterly results, our trajectory of rapid growth may have overshadowed these effects to date.

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

The success of our business depends, in part, on our ability to protect and enforce our trade secrets, trademarks, copyrights and patents and all of our other intellectual property rights, including our intellectual property rights underlying the Pandora service. We attempt to protect our intellectual property under trade secret, trademark, copyright and patent law, and through a combination of employee and third-party nondisclosure agreements, other contractual restrictions, technological measures and other methods. These afford only limited protection. Despite our efforts to protect our intellectual property rights and trade secrets, unauthorized parties may attempt to copy aspects of our song selection technology or obtain and use our trade secrets and other confidential information. Moreover, policing our intellectual property rights is difficult, costly and may not always be effective.

We have filed, and may in the future file, patent applications and we have purchased a portfolio of internet radio-related patents from a third party. It is possible, however, that these innovations may not be protectable. In addition, given the cost, effort,

risks and downside of obtaining patent protection, including the requirement to ultimately disclose the invention to the public, we may choose not to seek patent protection for certain innovations. However, such patent protection could later prove to be important to our business. Furthermore, there is always the possibility that our patent applications may not issue as granted patents, that the scope of the protection gained will be insufficient or that an issued patent may be deemed invalid or unenforceable. We also cannot guarantee that any of our present or future patents or other intellectual property rights will not lapse or be invalidated, circumvented, challenged or abandoned, that our intellectual property rights will provide competitive advantages to us, that our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes will not be limited by our relationships with third parties, that any of our pending or future patent applications will have the coverage originally sought, that our intellectual property rights will be enforced in jurisdictions where competition may be intense or where legal protection may be weak, or that we will not lose the ability to assert our intellectual property rights against or to license our technology to others and collect royalties or other payments.

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

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

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

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

Although we take steps to protect our intellectual property as discussed above, there can be no assurance, however, that changes in law will not be implemented, or changes in interpretation of such laws will occur, that will affect our ability to protect and enforce our patents and other intellectual property, including as a result of the 2011 passage of the America Invents Act of 2011, which codifies several significant changes to the U.S. patent laws and will remain subject to certain rule-making and interpretation, including changing from a "first to invent" to a "first inventor to file" system, limiting where a patentee may file a patent suit, requiring the apportionment of patent damages, replacing interference proceedings with derivation actions, and creating a post-grant opposition process to challenge patents after they have issued.

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

Internet, technology and media companies are frequently subject to litigation based on allegations of infringement, misappropriation or other violations of intellectual property rights. Some internet, technology and media companies, including some

of our competitors, own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims against us. In addition, we encourage our artists to submit content for our catalogue and we cannot be assured that artist representations made in connection with such submissions accurately reflect the legal rights of such content. Third parties have asserted, and may in the future assert, that we have infringed, misappropriated or otherwise violated their intellectual property rights. In addition, various federal and state laws and regulations govern the intellectual property and related rights associated with sound recordings and musical works. Existing laws and regulations are evolving and subject to different interpretations, and various federal and state legislative or regulatory bodies may expand current or enact new laws or regulations. We cannot assure you that we are not infringing or violating any third-party intellectual property rights.

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

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

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

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

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

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

- unanticipated costs or liabilities associated with the acquisition;
- incurrence of acquisition-related costs;
- diversion of management's attention from other business concerns;
- regulatory uncertainties;
- harm to our existing business relationships with business partners and advertisers as a result of the acquisition;

- harm to our brand and reputation;
- the potential loss of key employees;
- use of resources that are needed in other parts of our business; and
- use of substantial portions of our available cash to consummate the acquisition.

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

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

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

Expanding our operations into international markets is an element of our long-term strategy. For example, we recently began publicly performing and communicating to the public music as well as deploying advertising to listeners in New Zealand, Australia and their associated territories. However, offering our service outside of the United States involves numerous risks and challenges. Most importantly, while United States copyright law provides a statutory licensing regime for the public performance of sound recordings to listeners within the United States, there is no equivalent statutory licensing regime available outside of the United States, and many of the other licensing alternatives currently available in other countries are not commercially viable. Currently, the licensing terms offered by rights organizations and individual copyright owners in most countries outside the United States are prohibitively expensive. Addressing licensing structure and royalty rate issues in the United States required us to make very substantial investments of time, capital and other resources, and our business could have failed if such investments had not succeeded. Addressing these issues in foreign jurisdictions may require a commensurate investment by us, and there can be no assurance that we would succeed or achieve any return on this investment.

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

- the need to modify our technology and sell our solutions in non-English speaking countries;
- the need to localize our service to foreign customers' preferences and customs;
- the need to conform our marketing and advertising efforts with the laws and regulations of foreign jurisdictions, including, but not limited to, the use of any personal information about our listeners;
- the need to amend existing agreements and to enter into new agreements with automakers, automotive suppliers, consumer electronics manufacturers with products that integrate our service, and others in order to provide that service in foreign countries;
- difficulties in managing operations due to language barriers, distance, staffing, cultural differences and business infrastructure constraints and domestic laws regulating corporations that operate internationally;
- our lack of experience in marketing, and encouraging viral marketing growth without incurring significant marketing expenses, in foreign countries;
- application of foreign laws and regulations to us;
- fluctuations in currency exchange rates;
- reduced or ineffective protection of our intellectual property rights in some countries; and

- potential adverse tax consequences associated with foreign operations and revenue.

Furthermore, in most international markets, we would not be the first entrant, and our competitors may be better positioned than we are to succeed. In addition, in jurisdictions where copyright protection has been insufficient to protect against widespread music piracy, achieving market acceptance of our service may prove difficult as we would need to convince listeners to stream our service when they could otherwise download the same music for free. As a result of these obstacles, we may find it impossible or prohibitively expensive to enter or sustain our presence in foreign markets, or entry into foreign markets could be delayed, which could hinder our ability to grow our business.

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

At December 31, 2013, we had federal net operating loss carryforwards of approximately \$264.2 million and tax credit carryforwards of approximately \$5.3 million. At December 31, 2013, we had state net operating loss carryforwards of approximately \$245.2 million and tax credit carryforwards of approximately \$5.1 million. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, or the Code, if a corporation undergoes an "ownership change," the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes, such as research tax credits, to offset its post-change income may be limited. In general, an "ownership change" will occur if there is a cumulative change in our ownership by "5-percent shareholders" that exceeds 50 percentage points over a rolling three-year period. Similar rules may apply under state tax laws. As a result of prior equity issuances and other transactions in our stock, we have previously experienced "ownership changes" under section 382 of the Code and comparable state tax laws. We may also experience ownership changes in the future as a result of future transactions in our stock. As a result, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards or other pre-change tax attributes to offset United States federal and state taxable income is subject to limitations.

We could be subject to additional income tax liabilities.

We are subject to income taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating and estimating our worldwide income tax provision and accruals for these taxes. For example, our effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated in countries where we have higher statutory tax rates, by losses incurred in jurisdictions for which we are not able to realize the related tax benefit, by changes in foreign currency exchange rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in the relevant tax, accounting and other laws, regulations, principles and interpretations. We are also subject to tax audits in various jurisdictions, and such jurisdictions may assess additional income tax liabilities against us.

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

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

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

We collect and utilize demographic and other information, including personally identifiable information, from and about our listeners as they interact with our service. For example, to register for a Pandora account, our listeners must provide the following information: age, gender, zip code and e-mail address. Listeners must also provide their credit card or debit card numbers and other billing information in connection with additional service offerings. We also may collect information from our listeners when they enter information on their profile page, post comments on other listeners' pages, use other community or social networking features that are part of our service, participate in polls or contests or sign up to receive e-mail newsletters. Further, we and third parties use tracking technologies, including "cookies" and related technologies, to help us manage and track our listeners' interactions with our service and deliver relevant advertising. Third parties may, without our knowledge or consent, illegally obtain, transmit or utilize our listeners' personally identifiable information, or data associated with particular users or devices.

Various federal and state laws and regulations, as well as the laws of foreign jurisdictions in which we may choose to operate, govern the collection, use, retention, sharing and security of the data we receive from and about our listeners. Privacy groups and government bodies have increasingly scrutinized the ways in which companies link personal identities and data associated with particular users or devices with data collected through the internet, and we expect such scrutiny to continue to increase. Alleged violations of laws and regulations relating to privacy and data security, and any relevant claims, may expose us to potential liability and may require us to expend significant resources in responding to and defending such allegations and claims. Claims or allegations that we have violated laws and regulations relating to privacy and data security have resulted and could in the future result in negative publicity and a loss of confidence in us by our listeners and our advertisers, and may subject us to fines by credit card companies and loss of our ability to accept credit and debit card payments.

Existing privacy-related laws and regulations are evolving and subject to potentially differing interpretations, and various federal and state legislative and regulatory bodies, as well as foreign legislative and regulatory bodies, may expand current or enact new laws regarding privacy and data security-related matters. We may find it necessary or desirable to join self-regulatory bodies or other privacy-related organizations that require compliance with their rules pertaining to privacy and data security. We also may be bound by contractual obligations that limit our ability to collect, use, disclose and leverage listener data and to derive economic value from it. New laws, amendments to or re-interpretations of existing laws, rules of self-regulatory bodies, industry standards and contractual obligations, as well as changes in our listeners' expectations and demands regarding privacy and data security, may limit our ability to collect, use and disclose, and to leverage and derive economic value from listener data. We may also be required to expend significant resources to adapt to these changes and to develop new ways to deliver relevant advertising or otherwise provide value to our advertisers. In particular, government regulators have proposed "do not track" mechanisms, and requirements that users affirmatively "opt-in" to certain types of data collection that, if enacted into law or adopted by self-regulatory bodies or as part of industry standards, could significantly hinder our ability to collect and use data relating to listeners. Restrictions on our ability to collect, access and harness listener data, or to use or disclose listener data or any profiles that we develop using such data, would in turn limit our ability to stream personalized music content to our listeners and offer targeted advertising opportunities to our advertising customers, each of which are critical to the success of our business.

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

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

Techniques used to gain unauthorized access are constantly evolving, and we may be unable to anticipate or prevent unauthorized access to data pertaining to our listeners, including credit card and debit card information and other personally identifiable information. Like all internet services, our service, which is supported by our own systems and those of third-party vendors, is vulnerable to computer viruses, internet worms, break-ins, phishing attacks, attempts to overload servers with denial-of-service, attempts to access our servers to stream music or acquire playlists, or other attacks and similar disruptions from unauthorized use of our and third-party vendor computer systems, any of which could lead to system interruptions, delays, or shutdowns, causing loss of critical data or the unauthorized access to personally identifiable information. If an actual or perceived breach of security occurs of our systems or a vendor's systems, we may face civil liability and public perception of our security measures could be diminished, either of which would negatively affect our ability to attract listeners, which in turn would harm our efforts to attract and retain advertisers. We also would be required to expend significant resources to mitigate the breach of security and to address related matters. Unauthorized access to music or playlists would potentially create additional royalty obligations with no corresponding revenue.

We cannot control the actions of third parties who may have access to the listener data we collect. The integration of the Pandora service with applications provided by third parties represents a significant growth opportunity for us, but we may not be able to control such third parties' use of listeners' data, ensure their compliance with the terms of our privacy policies, or prevent unauthorized access to, or use or disclosure of, listener information, any of which could hinder or prevent our efforts with respect to growth opportunity. In addition, these third-party vendors may become the victim of security breaches, or have practices that may result in a breach and we may be responsible for those third-party acts or failures to act.

Any failure, or perceived failure, by us to maintain the security of data relating to our listeners and employees, to comply with our posted privacy policy, laws and regulations, rules of self-regulatory organizations, industry standards and contractual provisions to which we may be bound, could result in the loss of confidence in us, or result in actions against us by governmental

entities or others, all of which could result in litigation and financial losses, and could potentially cause us to lose listeners, advertisers, revenue and employees.

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

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

If we or any of our processing vendors have problems with our billing software, or the billing software malfunctions, it could have an adverse effect on our subscriber satisfaction and could cause one or more of the major credit card companies to disallow our continued use of their payment products. In addition, if our billing software fails to work properly and, as a result, we do not automatically charge our subscribers' credit cards on a timely basis or at all, or there are issues with financial insolvency of our third-party vendors or other unanticipated problems or events, we could lose subscription revenue, which would harm our operating results.

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

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

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

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

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

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

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

Although advertisers as a whole are spending an increasing amount of their overall advertising budget on online advertising, we face a number of challenges in growing our advertising revenue. We compete for advertising dollars with significantly larger and more established online marketing and media companies such as Facebook, Google, MSN and Yahoo!. We believe that the continued growth and acceptance of our online advertising products will depend on the perceived effectiveness and the acceptance of online advertising models generally, which is outside of our control. Any lack of growth in the market for online advertising could result in reduced revenue or increased marketing expenses, which would harm our operating results and financial condition.

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

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

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

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

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

Regulatory and consumer agencies have increasingly focused on distraction to drivers that may be associated with use of mobile and other devices in motor vehicles. In 2010, the U.S. Department of Transportation identified driver distraction as a top priority, and in April 2013, the National Highway Traffic Safety Administration (the "NHTSA") released new voluntary guidelines for visual-manual devices not related to the driving task that are integrated into motor vehicles. NHTSA also intends to propose guidelines applicable to after-market and portable devices that may be used in motor vehicles. Regulatory restrictions on how drivers and passengers in motor vehicles may engage with devices on which our service is broadcast could inhibit our ability to increase listener hours and generate ad revenue, which would harm our operating results. In addition, concerns over driver distraction due to use of mobile and other electronic devices to access our service in motor vehicles could result in litigation and negative publicity.

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

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

impairment in our relationship with these third-party licensors could harm our ability to maintain and expand the reach of our service, increase listener hours and sell advertising each of which could harm our operating results, cash flow and financial condition.

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

Our financial condition is affected by worldwide economic conditions and their impact on advertising spending. Expenditures by advertisers generally tend to reflect overall economic conditions, and to the extent that the economy continues to stagnate, reductions in spending by advertisers could have a serious adverse impact on our business. In addition, we provide an entertainment service, and payment for our Pandora One subscription service may be considered discretionary on the part of some of our current and prospective subscribers or listeners who may choose to use a competing free service or to listen to Pandora without subscribing. To the extent that overall economic conditions reduce spending on discretionary activities, our ability to retain current and obtain new subscribers could be hindered, which could reduce our subscription revenue and negatively impact our business.

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

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

Risks Related to Owning Our Common Stock

Our stock price has been and will likely continue to be volatile, and the value of an investment in our common stock may decline.

The trading price of our common stock has been and is likely to continue to be volatile. In addition to the risk factors described in this section and elsewhere in this Transition Report on Form 10-K, factors that may cause the price of our common stock to fluctuate include, but are not limited to:

- our actual or anticipated operating performance and the operating performance of similar companies in the internet, radio or digital media spaces;
- general economic conditions and their impact on advertising spending;
- the overall performance of the equity markets;
- the number of shares of our common stock publicly owned and available for trading;
- threatened or actual litigation;
- changes in laws or regulations relating to our service;
- any major change in our board of directors or management;
- publication of research reports about us or our industry or changes in recommendations or withdrawal of research coverage by securities analysts; and
- sales or expected sales of shares of our common stock by us, and our officers, directors and significant stockholders.

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

If securities or industry analysts cease publishing research, publish inaccurate or unfavorable research about our business or make projections that exceed our actual results, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If securities or industry analysts who cover us downgrade our stock or publish inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline. Furthermore, such analysts publish their own projections regarding our actual results. These projections may vary widely from one another and may not accurately predict the results we actually achieve. Our stock price may decline if we fail to meet securities and industry analysts' projections.

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

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

- a classified board of directors with three-year staggered terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;
- no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquiror;
- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of our board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- the requirement that a special meeting of stockholders may be called only by the chairman of our board of directors, our president, our secretary, or a majority vote of our board of directors, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;
- the requirement for the affirmative vote of holders of at least 66²/3% of the voting power of all of the then outstanding shares of the voting stock, voting together as a single class, to amend the provisions of our certificate of incorporation relating to the issuance of preferred stock and management of our business or our bylaws, which may inhibit the ability of an acquiror to effect such amendments to facilitate an unsolicited takeover attempt;
- the ability of our board of directors, by majority vote, to amend the bylaws, which may allow our board of directors to take additional actions to prevent an unsolicited takeover and inhibit the ability of an acquiror to amend the bylaws to facilitate an unsolicited takeover attempt; and
- advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of

us.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our principal executive offices are located in Oakland, California in a 98,872 square-foot facility, under a lease expiring on September 30, 2017. We also lease regional offices in Chicago, Illinois; Santa Monica, California; and New York, New York and local sales offices at various locations throughout the United States and in Sydney, Australia.

Our data centers are located in colocation facilities operated by Equinix in San Jose, California and Ashburn, Virginia as well as by Digital Realty Trust in Chicago, Illinois and are designed to be fault tolerant and operate at maximum uptime. Backup systems in California and Virginia can be brought online in the event of a failure at the other data centers. These redundancies enable fault tolerance and will also support our continued growth.

The data centers host the Pandora.com website and intranet applications that are used to manage the website content. The websites are designed to be fault-tolerant, with a collection of identical web servers connecting to an enterprise database. The design also includes load balancers, firewalls and routers that connect the components and provide connections to the internet. The failure of any individual component is not expected to affect the overall availability of our website.

We believe that our current facilities are adequate to meet our needs for the near future and that suitable additional or alternative space will be available on commercially reasonable terms to accommodate our foreseeable future operations.

ITEM 3. LEGAL PROCEEDINGS

The material set forth in Note 6 of Notes to Consolidated Financial Statements in Part II, Item 8 of this Transition Report on Form 10-K is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is traded on The New York Stock Exchange ("NYSE") under the symbol "P." The following table sets forth the range of high and low intra-day sales prices per share of our common stock for the periods indicated, as reported by the NYSE.

PRICE RANGE OF OUR COMMON STOCK

Our common stock has traded on the NYSE since June 15, 2011. Our initial public offering was priced at \$16.00 per share on June 14, 2011.

	High	Low
Eleven Months Ended December 31, 2013		
First quarter (February 1, 2013 - April 30, 2013)	\$ 14.27	\$ 11.36
Second quarter (May 1, 2013 - July 31, 2013)	\$ 20.52	\$ 13.94
Third quarter (August 1, 2013 - October 31, 2013)	\$ 28.17	\$ 18.16
Fourth quarter (November 1, 2013 - December 31, 2013) ⁽¹⁾	\$ 31.56	\$ 25.67
Twelve Months Ended January 31, 2013		
First quarter (February 1, 2012 - April 30, 2012)	\$ 15.25	\$ 7.83
Second quarter (May 1, 2012 - July 31, 2012)	\$ 12.30	\$ 8.50
Third quarter (August 1, 2012 - October 31, 2012)	\$ 12.57	\$ 7.38
Fourth quarter (November 1, 2012 - January 31, 2013)	\$ 11.90	\$ 7.08

(1) The fourth quarter of calendar 2013 (11-months) included two months (November 1, 2013 - December 31, 2013) as a result of the change in our fiscal year-end

On December 31, 2013, the closing price per share of our common stock as reported on the NYSE was \$26.60. As of December 31, 2013, there were approximately 71 holders of record of our common stock. The number of beneficial stockholders is substantially greater than the number of holders of record because a large portion of our common stock is held through brokerage firms.

Dividend Policy

We have not declared or paid any cash dividends on our common stock and currently do not anticipate paying any cash dividends in the foreseeable future. Instead, we intend to retain all available funds and any future earnings for us in the operation and expansion of our business. Any future determination relating to dividend policy will be made at the discretion of our board of directors and will depend on our future earnings, capital requirements, financial condition, future prospects, applicable Delaware law, which provides that dividends are only payable out of surplus or current net profits, and other factors that our board of directors deems relevant. In addition, our credit facility restricts our ability to pay dividends. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Our Indebtedness—Credit Facility" and Note 8 to our financial statements included elsewhere in this Transition Report on Form 10-K.

Equity Compensation Plan Information

For equity compensation plan information refer to Item 12 in Part III of this Transition Report on Form 10-K.

Stock Price Performance Graph

This performance graph shall not be deemed to be "soliciting material" or "filed" or incorporated by reference in future filings with the SEC, or subject to the liabilities of Section 18 of the Exchange Act except as shall be expressly set forth by specific reference in such filing.

The following graph shows a comparison from June 15, 2011, the date our common stock commenced trading on the NYSE, through December 31, 2013 of the total cumulative return of our common stock with the total cumulative return of the New York Stock Exchange Composite Index (the "NYA Composite"), the Global X Social Media Index (the "SOCL") and the SPDR Morgan Stanley Technology MTK Index (the "MTK"). The figures represented below assume an investment of \$100 in our common stock at the closing price of \$17.42 on June 15, 2011 and in the NYA Composite and MTK on the same date. The SOCL was modeled from the inception of the index on November 15, 2011. Data for the NYA Composite, MTK and SOCL assume reinvestment of dividends. The comparisons in the graph are historical and are not intended to forecast or be indicative of possible future performance of our common stock.

**Comparison of Cumulative Total Return Among Pandora Media, Inc.,
New York Stock Exchange Composite Index, Global X Social Media Index and
SPDR Morgan Stanley Technology MTK Index**



ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial and other data should be read in conjunction with, and are qualified by reference to, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and our audited consolidated financial statements and the accompanying notes included elsewhere in this report. The consolidated statement of operations and balance sheet data for the twelve months ended January 31, 2010 and 2011 and the consolidated balance sheet data as of January 31, 2010, 2011 and 2012 were derived from our audited consolidated financial statements not included in this report. The consolidated statements of operations data for the twelve months ended January 31, 2012 and 2013 for the eleven months ended December 31, 2013 and the consolidated balance sheet data as of January 31, 2013 and December 31, 2013 were derived from our audited consolidated financial statements included in this report. The consolidated statement of operations data for the eleven months ended December 31, 2012 is unaudited.

The historical results presented below are not necessarily indicative of financial results to be achieved in future periods.

	Twelve months ended				Eleven months ended	
	January 31,				December 31,	
	2010	2011	2012	2013	2012	2013
					(unaudited)	
	(in thousands, except per share data)					
Statement of Operations Data:						
Revenue:						
Advertising	\$ 50,147	\$ 119,333	\$ 239,957	\$ 375,218	\$ 343,318	\$ 489,340
Subscription and other	5,042	18,431	34,383	51,927	46,166	110,893
Total revenue	55,189	137,764	274,340	427,145	389,484	600,233
Cost of revenue:						
Cost of revenue—Content acquisition costs	32,946	69,357	148,708	258,748	230,731	314,866
Cost of revenue—Other(1)	7,892	11,559	22,759	32,019	28,740	41,844
Total cost of revenue	40,838	80,916	171,467	290,767	259,471	356,710
Gross profit	14,351	56,848	102,873	136,378	130,013	243,523
Operating Expenses:						
Product development(1)	6,026	6,736	13,425	18,118	16,191	29,986
Sales and marketing(1)	17,426	36,250	65,010	107,715	94,566	169,774
General and administrative(1)	6,358	14,183	35,428	48,247	43,320	70,212
Total operating expenses	29,810	57,169	113,863	174,080	154,077	269,972
Loss from operations	(15,459)	(321)	(10,990)	(37,702)	(24,064)	(26,449)
Other expense, net	(1,294)	(1,309)	(5,042)	(441)	(401)	(474)
Loss before provision for income taxes	(16,753)	(1,630)	(16,032)	(38,143)	(24,465)	(26,923)
Income tax benefit (expense)	—	(134)	(75)	(5)	3	(94)
Net loss	(16,753)	(1,764)	(16,107)	(38,148)	(24,462)	(27,017)
Deemed dividend on Series D and Series E	(1,443)	—	—	—	—	—
Accretion of redeemable convertible preferred stock	(218)	(300)	(110)	—	—	—
Increase in cumulative dividends payable upon conversion of liquidation of redeemable convertible preferred stock	(6,461)	(8,978)	(3,648)	—	—	—
Net loss attributable to common stockholders	\$ (24,875)	\$ (11,042)	\$ (19,865)	\$ (38,148)	\$ (24,462)	\$ (27,017)
Net loss per share, basic and diluted	\$ (3.84)	\$ (1.03)	\$ (0.19)	\$ (0.23)	\$ (0.15)	\$ (0.15)
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	6,482	10,761	105,955	168,294	167,956	180,968

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	\$ 18	\$ 85	\$ 582	\$ 1,214	\$ 1,109	\$ 1,946
Product development	125	329	1,638	4,530	4,138	8,802
Sales and marketing	225	549	4,866	12,294	11,128	20,222
General and administrative	109	492	2,101	7,462	6,908	9,071
Total stock-based compensation	\$ 477	\$ 1,455	\$ 9,187	\$ 25,500	\$ 23,283	\$ 40,041

Key Metrics (unaudited):(2)

	Twelve months ended			Eleven months ended	
	January 31,			December 31,	
	2011	2012	2013	2012	2013
			(in billions)		
Listener hours	3.83	8.23	14.01	12.56	15.31

	As of			As of	
	January 31,			December 31,	
	2011	2012	2013	2013	
			(in millions)		
Active users	29.3	47.6	65.6	76.2	

(2) Listener hours and active users are defined in the section entitled "Key Metrics" in Item 7 of this Transition Report on Form 10-K.

	As of January 31,				As of
					December 31,
	2010	2011	2012	2013	2013
			(in thousands)		
Balance Sheet Data:					
Cash and cash equivalents	\$ 16,164	\$ 43,048	\$ 44,126	\$ 65,725	\$ 245,755
Working capital	18,929	36,715	89,218	82,644	362,777
Total assets	40,277	99,209	178,015	218,832	673,335
Preferred stock warrant liability	300	1,027	—	—	—
Convertible preferred stock	104,806	126,662	—	—	—
Common stock and additional paid-in capital	1	2,309	205,971	238,569	675,123
Total stockholders' equity (deficit)	(87,771)	(83,010)	104,540	98,989	508,231

ITEM 7. 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 financial statements and the notes thereto included elsewhere in this Transition Report on Form 10-K. The following discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results may differ substantially from those referred to herein due to a number of factors, including but not limited to those discussed below and elsewhere in this report, particularly in the sections entitled "Special Note Regarding Forward-Looking Statements and Industry Data" and "Risk Factors."

We changed our fiscal year to the calendar twelve months ending December 31, effective beginning with the year ended December 31, 2013. As a result, our current fiscal period was shortened from twelve months to an eleven-month transition period ended on December 31, 2013. We reported our third fiscal quarter as the three months ended October 31, 2013, followed by a two-month transition period ended December 31, 2013.

In this MD&A, when financial results for the 2013 transition period are compared to financial results for the prior year period, the results compare the eleven-month period ended December 31, 2013 to the unaudited results for the eleven month period ended December 31, 2012. When financial results for fiscal 2013 are compared to financial results for fiscal 2012, the results compare our previous fiscal years, or the twelve-month periods ended January 31, 2013 and January 31, 2012. The following tables show the months included within the various comparison periods in our MD&A:

Calendar 2013 (11-month) Results Compared With Calendar 2012 (11-month recast, unaudited)

Calendar 2012 (11-month recast, unaudited)	Calendar 2013 (11-month)
February 2012 - December 2012	February 2013 - December 2013

Fiscal 2013 Results Compared With Fiscal 2012

2012	2013
February 2011 - January 2012	February 2012 - January 2013

Overview

Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements.

As of December 31, 2013, we had more than 200 million registered users, which we define as the total number of accounts that have been created for our service at period end. As of December 31, 2013 approximately 175 million registered users have accessed Pandora through smartphones and tablets. For the eleven months ended December 31, 2013, we streamed 15.31 billion hours of radio and as of December 31, 2013, we had 76.2 million active users during the prior 30 day period. According to a September 2013 report by Triton, we have more than a 70% share of internet radio among the top 20 stations and networks in the United States. Since we launched our free, advertising-supported radio service in 2005, our listeners have created over 5 billion stations.

At the core 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 100,000 artists, spanning over 500 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 or genre to start a station, the Pandora service instantly generates a station that plays music we think that listener will enjoy. Based on listener reactions to the songs we stream, we further tailor the station to match the listener's preferences in real time.

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 across all of our delivery platforms.
- *Pandora One.* Pandora One is provided to paying subscribers without any external advertising. Pandora One allows listeners to have more daily skips and enjoy higher quality audio on supported devices.

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 traditional computers, we have developed Pandora mobile device applications or "apps" for smartphones such as iPhone, Android and the Windows Phone and the iPhone and for tablets including the iPad and Android tablets. We distribute those mobile apps free to listeners via app stores. In addition, Pandora is now integrated with more than 1,000 connected devices, including automobiles, automotive aftermarket devices and consumer electronic devices.

Recent Key Events

In 2013, we integrated Pandora's advertising inventory into the leading radio media buying platforms, Mediaocean and STRATA, and we are continuing to enhance the ability of radio advertisers to purchase media on these platforms which incorporate Triton measurements of our radio audience reach side-by-side with terrestrial radio metrics. In addition, we have invested in building a local sales force in major radio markets. In January 2014, we began rolling out in-car advertising solutions which will run across the vehicle models that include a native Pandora integration. Our integration into standard radio media-buying processes and measurement, our in-car advertising solutions and our local ad sales force are key elements of our strategy for expanded penetration of the radio advertising market.

In June 2013, we entered into a local marketing agreement to program KXMZ-FM, a Rapid City, South Dakota-area terrestrial radio station. In addition, we entered into an agreement to purchase the assets of KXMZ-FM for a total purchase price of approximately \$0.6 million in cash, subject to certain closing conditions. These agreements were made in part to allow us to qualify for certain settlement agreements concerning royalties for the public performance of musical works between the Radio Music Licensing Committee ("RMLC") and the American Society of Composers, Authors and Publishers ("ASCAP") and Broadcast Music, Inc. ("BMI"), respectively. Completion of the KXMZ-FM acquisition is subject to various closing conditions. These include, but are not limited to, regulatory approval by the Federal Communications Commission. Upon completion of these conditions, we expect to account for this transaction as a business combination.

In September 2013, we completed a follow-on public equity offering in which we sold an aggregate of 15,730,000 shares of our common stock, inclusive of 2,730,000 shares sold pursuant to the exercise by the underwriters of an option to purchase additional shares, at a public offering price of \$25.00 per share. In addition, another 5,200,000 shares were sold by certain selling stockholders. We received aggregate net proceeds of \$378.7 million, after deducting underwriting discounts and commissions and offering expenses from sales of our shares in the offering. We did not receive any of the proceeds from the sales of shares by the selling stockholders. We anticipate that we will use the net proceeds of this offering for general corporate purposes, including working capital and capital expenditures. In addition, we may use a portion of the net proceeds for potential acquisitions of businesses, products or technologies, although we have no current agreements or understandings with respect to any such transactions.

Factors Affecting our Business Model

As our mobile listenership increases, we face new challenges in optimizing our advertising products for delivery on mobile and other connected device platforms and monetizing inventory generated by listeners using these platforms. The mobile digital advertising market is at an early stage of development, with lower overall spending levels than traditional online advertising markets, and faces technical challenges due to fragmented platforms and lack of standard audience measurement protocols. As a greater share of our listenership is consumed on mobile devices, our ability to monetize increased mobile streaming may not keep up with our past monetization of streaming to desktop computers and laptops.

In addition, our strategy includes increasing the number of ad campaigns for traditional computer, mobile and other connected device platforms sold to local advertisers, placing us in more direct competition with broadcast radio for advertiser spending, especially for audio advertisements. By contrast, historically our display advertisers have been predominantly national brands. To successfully monetize our growing listener hours, we may have 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, and

in particular, audio advertising products, across the range of our delivery platforms.

Growth in our active users and distribution platforms has fueled a corresponding growth in listener hours. Our total number of listener hours is a key driver for both revenue generation opportunities and content acquisition 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. In turn, our ability to generate revenue depends on the extent to which we are able to sell the inventory we have.
- *Cost of Revenue—Content Acquisition Costs.* The number of sound recordings we transmit to users of the Pandora service, as generally reflected by listener hours, drives substantially all 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.

We pay royalties to the copyright owners, or their agents, of each sound recording that we stream and to the copyright owners, or their agents, of the musical work embodied in that sound recording, subject to certain exclusions. Royalties for sound recordings are negotiated with and paid to record labels or to SoundExchange, a performing rights organization (“PRO”) authorized to collect royalties on behalf of all sound recording copyright owners. Royalties for musical works are most often negotiated with and paid to PROs such as ASCAP, BMI and SESAC or directly to publishing companies such as Sony/ATV. Royalties are calculated based on the number of sound recordings streamed, revenue earned or other usage measures. Refer to “Musical Works” in the Business section for more information.

We stream spoken word comedy content pursuant to a federal statutory license, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization or the copyright owner of such content. However, we pay royalties to SoundExchange at rates negotiated between representatives of online music services and SoundExchange for the right to stream this spoken word comedy content.

Given the current royalty structures in effect through 2015 with respect to the public performance of sound recordings in the United States, 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 depends on our ability to increase our revenue per hour of streaming through increased advertising sales across all of our delivery platforms.

Until September 2011, for listeners who are not subscribers, we limited usage of our advertising-supported service on traditional, desktop and laptop, computers to 40 hours per month. Listeners who reached this limit could continue to use this service by paying \$0.99 for the remainder of the month. We included this revenue in subscription and other revenue. In September 2011, we effectively eliminated the 40 hour per month listening cap on traditional computers by increasing the cap to 320 hours of listening per month, which almost none of our listeners exceed.

In March 2013, we instituted a 40 hour per month listening limit for our advertising supported service on certain mobile and other connected devices. Listeners who reached this limit could continue to use our ad supported service on these devices by paying \$0.99 for the remainder of the month, could listen to our ad supported service on their traditional computers, or could purchase Pandora One subscriptions for \$36 per year or approximately \$4 per month. Effective September 2013, we eliminated this limit primarily due to our improved ability to monetize mobile listener hours. Although we have removed the broad 40 hour per month mobile listening limit, we have implemented other more precise measures that we believe will allow us to better manage the growth of content acquisition costs while minimizing adverse effects on the listener experience. In addition, while the mobile listening limit drove significant growth in subscribers, this growth has moderated subsequent to removing the limit.

As the volume of music we stream to listeners in the United States increases, our content acquisition costs will also increase, regardless of whether we are able to generate more revenue. In addition, we expect to invest heavily in our operations to support anticipated future growth. One of our key objectives is furthering our market leadership in internet radio, 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. For the foreseeable future, we expect that there will be periods during which our ability to monetize listener hours will lag behind the growth of listener hours. As our business matures, we expect that the growth rate in our listener hours will decline relative to our increased ability to monetize listener hours. However, we expect to incur net losses on a U.S. GAAP basis in the near term.

Our current strategy is to leverage any improvements in gross profit by investing in broadening distribution channels,

developing innovative and scalable advertising products, increasing utilization of advertising inventory and building our sales force. These investments are intended to drive further growth in our business through both increased listener hours and monetization of those hours, and as a result we are targeting gradual improvements in gross profit over time. Our planned reinvestment of any resulting incremental gross profit will continue to depress any growth of bottom line profitability. In this regard, we do not expect significant improvements in our earnings per share for calendar year 2014 relative to calendar year 2013.

Key Metrics

Listener Hours

The table below sets forth our listener hours for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013.

	Twelve months ended January 31,		Eleven months ended December 31,	
	2012	2013	2012	2013
	(in billions)			
Listener hours	8.23	14.01	12.56	15.31

We track listener hours because it is a key indicator of the growth of our business. 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. We believe this server-based approach is the best methodology to forecast advertising inventory given that advertisements are frequently served in between tracks and are often served upon triggers such as a listener clicking thumbs-down or choosing to skip a track. 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.

Active Users

The table below sets forth our active users as of January 31, 2013 and December 31, 2013.

	As of January 31, 2013	As of December 31, 2013
	(in millions)	
Active users	65.6	76.2

We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time, which is particularly important to potential advertisers. Active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts. We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time, which is particularly important to potential advertisers.

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

The table below sets forth our ad RPMs, including total, traditional computer and mobile and other connected devices ad RPMs for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013.

	Twelve months ended January 31,		Eleven months ended December 31,	
	2012	2013	2012	2013
Total ad RPMs	\$ 32.22	\$ 29.13	\$ 29.60	\$ 36.70
Traditional computer	62.68	53.73	54.51	56.79
Mobile and other connected devices	21.05	22.53	22.80	31.97

We track ad RPMs for our free, advertising supported service because it is a key indicator of our ability to monetize advertising inventory created by our listener hours. We focus on total ad RPMs across all of our delivery platforms. Ad RPMs compare advertising revenue generated in a given period to advertising supported listener hours in the period and we believe such total ad RPMs to be the central top-line indicator for evaluating the results of our monetization efforts. We calculate total ad RPMs by dividing advertising revenue we generate by the number of thousands of listener hours of our advertising-based service.

We also provide estimates of disaggregated ad RPMs for our traditional computer platform as well as our mobile and other connected devices platforms, which we calculate by dividing the estimated advertising revenue generated through the respective platforms by the number of thousands of listener hours of our advertising-based service delivered through such platforms. While we believe that such disaggregated ad RPMs provide directional insight for evaluating our efforts to monetize our service by platform, we do not validate disaggregated ad RPMs to the level of financial statement reporting. Such metrics should be seen as indicative only and as management's best estimate. We continue to refine our systems and methodologies used to categorize ad RPMs across our delivery platforms. 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.

Total ad RPMs

For the eleven months ended December 31, 2012 and 2013, total ad RPMs increased compared to the respective prior year period as advertising sales growth outpaced the growth in advertising-supported listener hours primarily due to an increase in the number of ads delivered, as well as an increase in the average price per ad. In addition, total ad RPMs benefited from measures we implemented in 2013 to better manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience.

For the twelve months ended January 31, 2012 and 2013, total ad RPMs decreased compared to the respective prior year period, as the growth in listener hours outpaced the growth in advertising revenue, primarily due to the effective elimination of the 40 hour per month listening cap on traditional computers in September 2011.

Traditional computer ad RPMs

For the eleven months ended December 31, 2012 and 2013, traditional computer ad RPMs increased compared to the respective prior year period, as the growth in traditional computer revenue outpaced the growth in listener hours on that platform primarily due to an increase in the average price per ad.

For the twelve months ended January 31, 2012 and 2013, traditional computer ad RPMs decreased compared to the respective prior year period, as the growth in listener hours outpaced the growth in advertising revenue on that platform, primarily due to the effective elimination of the 40 hour per month listening cap on traditional computers in September 2011.

Mobile and other connected device ad RPMs

For the eleven months ended December 31, 2012 and 2013, mobile and other connected device ad RPMs increased compared to the respective prior year period, as the growth in mobile and other connected devices revenue outpaced the growth in listener hours on those platforms primarily due to an increase in the number of ads delivered and an increase in the average price per ad. In addition, mobile and other connected device ad RPMs benefited from measures we implemented in 2013 to better manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience.

For the twelve months ended January 31, 2012 and 2013, mobile and other connected device ad RPMs increased compared to the respective prior year period, as the growth in mobile and connected devices revenue outpaced the growth in listener hours on those platforms. The increase in RPMs for the twelve months ended January 31, 2013 was partially offset by the effect of direct advertising sales to one customer which accounted for 9% of revenue in the twelve months ended January 31, 2012.

Total Revenue per Thousand Listener Hours ("total RPMs")

The table below sets forth our total RPMs, including total, traditional computer and mobile and other connected devices total RPMs for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013.

	Twelve months ended		Eleven months ended	
	January 31,		December 31,	
	2012	2013	2012	2013
Total RPMs	\$ 33.32	\$ 30.49	\$ 30.88	\$ 39.22
Traditional computer	58.84	52.36	52.98	56.01
Mobile and other connected devices	21.93	23.83	24.03	34.98

We track revenue per thousand listener hours for our service because it is a key indicator of our ability to monetize our listener hours. We focus on total RPMs across all of our delivery platforms. Total RPMs compare advertising and subscription and other revenue generated in a given period to total listener hours in the period. We calculate total RPMs by dividing the total revenue generated by the number of thousands of listener hours.

The estimates used to derive disaggregated total RPMs for our traditional computer platform as well as our mobile and other connected devices platforms are similar to those used to derive ad RPMs. The changes in total RPMs were driven by the same factors mentioned above within the discussion of ad RPMs.

Licensing Costs per Thousand Listener Hours (“LPMs”)

The table below sets forth our total LPMs for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013.

	Twelve months ended		Eleven months ended	
	January 31,		December 31,	
	2012	2013	2012	2013
Total LPMs	\$ 18.06	\$ 18.47	\$ 18.30	\$ 20.57

We track licensing costs per thousand listener hours 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 increases which drive period over period changes in LPMs. As such, the margin on our business varies principally with variances in ad RPMs and subscription RPMs. Total LPMs in the twelve months ended January 31, 2013 and the eleven months ended December 31, 2013 increased compared to the respective prior year periods primarily due to scheduled rate increases.

Basis of Presentation and Results of Operations

The following tables present 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.

	Twelve months ended January 31,		Eleven months ended December 31,	
	2012	2013	2012 (unaudited)	2013
Revenue:				
Advertising	87 %	88 %	88 %	82 %
Subscription and other	13	12	12	18
Total revenue	100	100	100	100
Cost of revenue:				
Cost of revenue — Content acquisition costs	54	61	59	52
Cost of revenue — Other(1)	8	7	7	7
Total cost of revenue	62	68	66	59
Gross profit	38	32	34	41
Operating expenses:				
Product development(1)	5	4	4	5
Sales and marketing(1)	24	25	24	28
General and administrative(1)	13	11	11	12
Total operating expenses	42	40	39	45
Loss from operations	(4)	(8)	(5)	(4)
Other income (expense):				
Interest income	-	-	-	-
Interest expense	-	-	-	-
Other expense, net	(2)	-	-	-
Loss before provision for income taxes	(6)	(8)	(5)	(4)
Income tax benefit (expense)	-	-	0	0
Net loss	(6) %	(8) %	(5) %	(4) %

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	0.2 %	0.3 %	0.3 %	0.3 %
Product development	0.6	1.1	1.1	1.5
Sales and marketing	1.8	2.9	2.9	3.4
General and administrative	0.8	1.7	1.8	1.5

Revenue

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012 (unaudited)	2013	\$ Change
		(in thousands)			(in thousands)	
Advertising	\$ 239,957	\$ 375,218	\$ 135,261	\$ 343,318	\$ 489,340	\$ 146,022
Subscription and other	34,383	51,927	17,544	46,166	110,893	64,727
Total revenue	\$ 274,340	\$ 427,145	\$ 152,805	\$ 389,484	\$ 600,233	\$ 210,749

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 and brokers pursuant to which we provide the ability to sell advertising inventory on our service directly to advertisers. We report revenue under these arrangements net of amounts due to agencies and brokers. For the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013, advertising revenue accounted for 87%, 88%, 88% (unaudited) and 82% of our total revenue, respectively, and we expect that advertising will comprise a substantial majority of revenue for the foreseeable future.

For the eleven months ended December 31, 2012 compared to 2013, advertising revenue increased by \$146.0 million or approximately 40%, primarily due to an approximate 30% increase in the number of ads delivered, as well as an increase in the average price per ad of approximately 10%. The increase in the number of ads delivered was primarily due to an increase in total advertising listener hours of approximately 15%, which increased the volume of advertising inventory, as well as an increase in our sales force year-over-year to sell such advertising inventory and an increase in ad capacity per hour of approximately 10%. The increase in the average price per ad was due primarily to changes in the sales distribution mix amongst direct sales, third-party network sales, and other channels and the platform mix between traditional computer and mobile and other connected devices.

For the twelve months ended January 31, 2012 compared to 2013, advertising revenue increased by \$135.3 million or approximately 56%, primarily due to an approximate 100% increase in the number of ads delivered, partially offset by a decrease in the average price per ad of approximately 20% due to fluctuations in the sales distribution mix amongst direct sales, third-party network sales, and other channels and the platform mix between traditional computer and mobile and other connected devices. The increase in the number of ads delivered was primarily due to an increase in total listener hours of approximately 70%, which increased the volume of advertising inventory, as well as an increase in our sales force year-over-year to sell such advertising inventory.

Subscription and other revenue. Subscription and other revenue is generated primarily through the sale of 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 derived from direct sales to listeners is recognized on a straight-line basis over the duration of the subscription period, although in certain cases described below subscription revenue is currently subject to deferral pending the expiration of refund rights. For the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013, subscription and other revenue accounted for 13%, 12%, 12% (unaudited) and 18% of our total revenue, respectively.

For the eleven months ended December 31, 2012 compared to 2013, subscription and other revenue increased by \$64.7 million, or approximately 140%, due to an increase in the number of subscribers, partially driven by the implementation of the mobile listening limit, which was implemented in March 2013 and eliminated in September 2013.

For the twelve months ended January 31, 2012 compared to 2013, subscription and other revenue increased \$17.5 million, or approximately 50%, due to an increase in the number of subscribers.

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 some mobile operating systems 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 reserve. As of December 31, 2013, we had deferred all revenue subject to certain refund rights totaling approximately \$14.2 million, as we do not currently have sufficient history to estimate a reserve. We expect that we will have sufficient history to estimate the reserve in January 2014. As a result, our revenue results will include a one-time reversal of substantially all of the deferred revenue related to the subscription return reserve in the first quarter of calendar year 2014.

Costs and Expenses

Cost of revenue consists of cost of revenue – content acquisition costs and cost of revenue – other. 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

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012	2013	\$ Change
	(in thousands)			(unaudited)	(in thousands)	
Cost of revenue - Content acquisition costs	\$ 148,708	\$ 258,748	\$ 110,040	\$ 230,731	\$ 314,866	\$ 84,135

Content acquisition costs as a percentage of advertising revenue by platform

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013		2012	2013	
				(unaudited)		
Traditional computer	29 %	35 %		34 %	34 %	
Mobile and other connected devices	78 %	76 %		75 %	58 %	

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 and are based on both percentage of revenue and listening metrics. 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 or a formula that involves a combination of per performance and revenue metrics. For royalty arrangements under negotiation, we accrue for estimated royalties based on the available facts and circumstances and adjust these estimates as more information becomes available. The results of any finalized negotiation may be materially different from our estimates.

We estimate our advertising-based content acquisition costs attributable to specific platforms by allocating costs from royalties payable based on a fee per track to the platform for which the track is served and by allocating costs from royalties based on a percentage of our revenue in accordance with the overall percentage of our revenue estimated to be attributable to such platforms. While we believe that comparing disaggregated content acquisition costs and revenues across our delivery platforms may provide directional insight for evaluating our efforts to monetize the rapid adoption of our service on mobile and other connected devices, we do not validate such disaggregated metrics to the level of financial statement reporting. We continue to refine our systems and methodologies used to categorize such metrics across our delivery platforms and the period-to-period comparisons of results are not necessarily indicative of results for future periods.

For the eleven months ended December 31, 2012 compared to 2013, content acquisition costs increased by \$84.1 million due to increased listener hours, higher royalty rates due to scheduled rate increases and increased revenue. Content acquisition costs as a percentage of total revenue decreased from 59% (unaudited) to 52%, primarily due to an increase in advertising sales and the effect of measures we have adopted to manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience, partially offset by scheduled rate increases. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our traditional computer platform were 34% in both the eleven months ended December 31, 2012 and 2013, primarily due to increases in advertising sales on that platform that were offset by scheduled rate increases. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our mobile and other connected devices platforms decreased from 75% (unaudited) to 58%, primarily due to an increase in advertising sales on those platforms and the effect of measures we have adopted to manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience, partially offset by scheduled rate increases.

For the twelve months ended January 31, 2012 compared to 2013, content acquisition costs increased by \$110.0 million due to increased royalty payments driven by increased listener hours and higher royalty rates due to scheduled rate increases and higher revenue. Content acquisition costs as a percentage of total revenue increased from 54% to 61%, primarily due to increased listener hours, higher royalty rates due to scheduled rate increases and increased revenue. Estimated content acquisition costs as a percentage of the revenue attributable to our traditional computer platform increased from 29% to 35%, primarily due to an increase in listener hours as a result of the effective elimination of the 40 hour per month listening cap on traditional computers and scheduled rate

increases. Estimated content acquisition costs as a percentage of the revenue attributable to our mobile and other connected devices platforms decreased from 78% to 76%, primarily due to the an increase in advertising sales on those platforms.

Cost of revenue—other

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012	2013	\$ Change
	(in thousands)			(unaudited)	(in thousands)	
Cost of revenue — Other	\$ 22,759	\$ 32,019	\$ 9,260	\$ 28,740	\$ 41,844	\$ 13,104

Cost of revenue—Other consists primarily of hosting, infrastructure and the employee-related costs associated with supporting those functions. Hosting 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 or click-through actions are delivered or occur, and accordingly, we record this as a cost of revenue in the related period.

For the eleven months ended December 31, 2012 compared to 2013, cost of revenue increased by \$13.1 million primarily due to an \$8.5 million increase in ad serving costs and hosting costs driven by an increase in advertising revenue and listener hours, a \$2.8 million increase in employee-related costs driven by an increase in headcount and a \$2.1 million increase in infrastructure costs primarily driven by an increase in listener hours.

For the twelve months ended January 31, 2012 compared to 2013, cost of revenue increased by \$9.3 million due to a \$5.3 million increase in ad serving and costs and hosting services costs driven by an increase in advertising revenue and listener hours, a \$2.0 million increase in employee-related costs driven by an increase in headcount and a \$1.8 million increase in infrastructure costs primarily driven by an increase in listener hours.

Gross profit

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012	2013	\$ Change
	(in thousands)			(unaudited)	(in thousands)	
Total revenue	\$ 274,340	\$ 427,145	\$ 152,805	\$ 389,484	\$ 600,233	\$ 210,749
Total cost of revenue	171,467	290,767	119,300	259,471	356,710	97,239
Gross profit	\$ 102,873	\$ 136,378	\$ 33,505	\$ 130,013	\$ 243,523	\$ 113,510
Gross margin	37%	32%		33%	41%	

For the eleven months ended December 31, 2012 compared to 2013, gross profit increased by \$113.5 million primarily due to an increase in advertising revenue as a result of an increase in the number of ads delivered. Gross margin increased from 33% (unaudited) to 41% as the growth in advertising revenue outpaced the growth in content acquisition costs primarily due to an increase in the number of ads delivered and the effect of the measures we adopted to manage the growth of mobile content acquisition costs.

For the twelve months ended January 31, 2012 compared to 2013, gross profit increased by \$33.5 million primarily due to an increase in advertising revenue as a result of an increase in the number of ads delivered. Gross margin decreased from 37% to 32% as the growth in content acquisition costs outpaced the growth in revenue primarily due to an increase in listener hours in connection with the removal of the 40 hour traditional computer listening cap in September 2011.

Product development

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012	2013	\$ Change
	(in thousands)			(unaudited)	(in thousands)	
Product development	\$ 13,425	\$ 18,118	\$ 4,693	\$ 16,191	\$ 29,986	\$ 13,795

Product development consists primarily of employee-related costs, including salaries and benefits related to employees in software engineering, music analysis and product management departments, facilities-related expenses, information technology and costs associated with supporting consumer connected-device manufacturers in implementing our service in their products. We incur product development expenses primarily for improvements to our website and the Pandora app, development of new advertising products and development and enhancement of our personalized station(s) generating system. We have generally expensed product development as incurred. Certain website development and internal use software development costs may be 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 intend to continue making significant investments in developing new products and enhancing the functionality of our existing products.

For the eleven months ended December 31, 2012 compared to 2013, product development expenses increased by \$13.8 million primarily due to a \$13.2 million increase in employee-related costs primarily driven by an increase in headcount.

For the twelve months ended January 31, 2012 compared to 2013, product development expenses increased by \$4.7 million primarily due to a \$5.0 million increase in employee-related costs primarily driven by an increase in headcount.

Sales and marketing

	Twelve months ended			Eleven months ended		
	January 31,			December 31,		
	2012	2013	\$ Change	2012	2013	\$ Change
	(in thousands)			(unaudited)	(in thousands)	
Sales and marketing	\$ 65,010	\$ 107,715	\$ 42,705	\$ 94,566	\$ 169,774	\$ 75,208

Sales and marketing consists primarily of employee-related costs, including salaries, commissions and benefits related to employees in sales, sales support and marketing departments. In addition, sales and marketing expenses include transaction processing fees for subscription purchases on mobile platforms, external sales and marketing expenses such as third-party marketing, branding, advertising and public relations expenses, facilities-related expenses, infrastructure costs and credit card fees. We expect sales and marketing expenses to increase as we hire additional personnel to build out our sales and sales support teams.

For the eleven months ended December 31, 2012 compared to 2013, sales and marketing expenses increased by \$75.2 million primarily due to a \$44.9 million increase in employee-related costs and a \$5.4 million increase in facilities and equipment expenses, both of which were primarily driven by an increase in headcount, a \$16.1 million increase in transaction processing fees for subscription purchases on mobile platforms and a \$9.1 million increase in marketing expenses.

For the twelve months ended January 31, 2012 compared to 2013, sales and marketing expenses increased by \$42.7 million primarily due to a \$33.2 million increase in employee-related costs and a \$3.0 million increase in facilities and equipment expenses, both of which were primarily driven by an increase in headcount, and a \$4.8 million increase in transaction processing fees for subscription purchases on mobile platforms.

General and administrative

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012	2013	\$ Change
		(in thousands)		(unaudited)	(in thousands)	
General and administrative	\$ 35,428	\$ 48,247	\$ 12,819	\$ 43,320	\$ 70,212	\$ 26,892

General and administrative consists primarily of employee-related costs, consisting of salaries and benefits 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, facilities-related expenses and infrastructure costs. 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.

For the eleven months ended December 31, 2012 compared to 2013, general and administrative expenses increased by \$26.9 million primarily due to an \$11.7 million increase in professional fees, a \$10.5 million increase in employee-related costs and a \$2.4

million increase in facilities and equipment expenses, both of which were primarily driven by an increase in headcount.

For the twelve months ended January 31, 2012 compared to 2013, general and administrative expenses increased by \$12.8 million primarily due to a \$10.4 million increase in employee-related costs and a \$1.4 million increase in facilities and equipment expenses, both of which were primarily driven by an increase in headcount.

Income tax benefit (expense)

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

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

Other income (expense)

	Twelve months ended January 31,			Eleven months ended December 31,		
	2012	2013	\$ Change	2012 (unaudited)	2013	\$ Change
	(in thousands)			(in thousands)		
Interest income	\$ 59	\$ 95	\$ 36	\$ 88	\$ 96	\$ 8
Interest expense	(616)	(535)	81	(486)	(554)	(68)
Other expense, net	(4,485)	(1)	4,484	(3)	(16)	(13)
Total other expense	<u>\$ (5,042)</u>	<u>\$ (441)</u>	<u>\$ 4,601</u>	<u>\$ (401)</u>	<u>\$ (474)</u>	<u>\$ (73)</u>

For the eleven months ended December 31, 2012 compared to 2013, total other expense increased by \$0.1 million primarily driven by a \$0.1 million increase in interest expense.

For the twelve months ended January 31, 2012 compared to 2013, total other expense decreased by \$4.6 million primarily due to a \$4.5 million decrease in expenses recorded in connection with the warrant remeasurement during the twelve months ended January 31, 2012, which was due to the change in the fair market value of our common stock. Upon the IPO in June 2011, this liability was eliminated, resulting in a corresponding decrease in other expense.

Liquidity and Capital Resources

As of December 31, 2013 we had cash, cash equivalents and investments totaling \$450.1 million, which consisted of cash and money market funds held at major financial institutions, commercial paper, investment-grade corporate debt securities and U.S. government and government agency debt securities.

In September 2013, we completed a follow-on public equity offering in which we sold an aggregate of 15,730,000 shares of our common stock, inclusive of 2,730,000 shares sold pursuant to the exercise by the underwriters of an option to purchase additional shares, at a public offering price of \$25.00 per share. In addition, another 5,200,000 shares were sold by certain selling stockholders. We received aggregate net proceeds of \$378.7 million, after deducting underwriting discounts and commissions and offering expenses from sales of our shares in the offering. We did not receive any of the proceeds from the sales of shares by the selling stockholders.

The principal uses of our cash during the eleven months ended December 31, 2013 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

In May 2011, we entered into a \$30.0 million credit facility with a syndicate of financial institutions. In September 2013, we amended this credit facility. The amendment increased the aggregate commitment amount from \$30.0 million to \$60.0 million, extended the maturity date from May 12, 2015 to September 12, 2018 and decreased the interest rate on borrowings. Refer to Note 8 “Debt Instruments” in the Notes to Consolidated Financial Statements for further details regarding our credit facility.

In July 2013, we borrowed approximately \$10.0 million from the credit facility to enhance our working capital position. This amount was paid off in full in August 2013.

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 twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013.

	Twelve months ended		Eleven months ended	
	January 31,		December 31,	
	2012	2013	2012	2013
	(in thousands)		(unaudited)	
	(in thousands)		(in thousands)	
Net cash provided by (used in) operating activities	\$ 5,358	\$ (250)	\$ 1,702	\$ (2,986)
Net cash provided by (used in) investing activities	(58,550)	15,185	8,235	(211,919)
Net cash provided by financing activities	54,270	6,669	5,877	394,997

Operating activities

In the eleven months ended December 31, 2013, net cash used in operating activities was \$3.0 million, including our net loss of \$27.0 million, which was offset by non-cash charges of \$50.6 million primarily related to \$40.0 million in stock-based compensation expense. Net cash used in operating activities benefited from a \$13.4 million increase in deferred revenue from the prior period primarily due to an increase in subscriptions, partially driven by the temporary implementation of the mobile listening limit and an increase in accrued royalties of \$13.0 million due to schedule rate increases, offset by a \$60.6 million increase in accounts receivable driven by an increase in revenue.

In the eleven months ended December 31, 2012, net cash provided by operating activities was \$1.7 million (unaudited), primarily due to non-cash charges of \$31.5 million (unaudited) primarily related to \$23.3 million (unaudited) in stock-based compensation expense, offset by our net loss of \$24.5 million (unaudited). Net cash provided by operating activities benefited from an increase in accrued royalties of \$17.5 million (unaudited) due to schedule rate increases and a \$10.3 million (unaudited) increase in deferred revenue primarily due to an increase in customers purchasing subscriptions for Pandora One, offset by an increase in accounts receivable of \$43.5 million (unaudited) driven by an increase in revenue.

In the twelve months ended January 31, 2013, net cash used in operating activities was \$0.3 million, including our net loss of \$38.1 million, offset by non-cash charges of \$33.2 million primarily related to stock-based compensation expense. Net cash used in operating activities benefited an increase in accrued royalties of \$19.3 million due to schedule rate increases and an increase in deferred revenue of \$10.0 million primarily due to an increase in customers purchasing subscriptions for Pandora One, offset by an increase in accounts receivable of \$36.7 million driven by an increase in revenue.

In the twelve months ended January 31, 2012, net cash provided by operating activities was \$5.4 million, including non-cash charges of \$18.9 million primarily related to stock-based compensation expense, offset by our net loss of \$16.1 million. In addition, cash provided by operating activities benefitted from an increase in accrued royalties of \$15.7 million due to schedule rate increases

and a \$3.3 million increase in deferred revenue primarily related to an increase in customers purchasing subscriptions for Pandora One, offset by an increase in accounts receivable of \$24.5 million driven by an increase in revenue.

Investing activities

In the eleven months ended December 31, 2013, net cash used in investing activities was \$211.9 million, primarily due to \$224.5 million for purchases of investments, \$42.2 million in maturities of short-term investments, \$21.2 million for capital expenditures for server equipment and leasehold improvements and \$8.0 million for the purchase of patents.

In the eleven months ended December 31, 2012, net cash provided by investing activities was \$8.2 million (unaudited), primarily consisting of \$79.6 million (unaudited) in maturities of short-term investments offset by \$59.6 million (unaudited) for the purchases of investments.

In the twelve months ended January 31, 2013, net cash provided by investing activities was \$15.2 million, primarily consisting of \$87.9 million in maturities of short-term investments, offset by \$65.2 million for the purchases of investments.

In the twelve months ended January 31, 2012, net cash used in investing activities was \$58.6 million, primarily consisting of \$66.9 million for the purchases of investments, offset by \$20.0 million in maturities of short-term investments.

Financing activities

In the eleven months ended December 31, 2013, net cash provided by financing activities was \$395.0 million, primarily consisting of net proceeds from the follow-on public equity offering of \$378.7 million and cash proceeds from the issuance of common stock of \$16.8 million.

In the eleven months ended December 31, 2012, net cash provided by financing activities was \$5.9 million (unaudited), primarily consisting of proceeds from the issuance of common stock.

In the twelve months ended January 31, 2013, net cash provided by financing activities was \$6.7 million, primarily consisting of proceeds from the issuance of common stock.

In the twelve months ended January 31, 2012, net cash provided by financing activities was \$54.3 million, primarily consisting of net proceeds of \$90.6 million from issuance of common stock in our IPO, partially offset by the payment of \$31.0 million in dividends upon conversion of the redeemable convertible preferred stock in connection with our IPO and repayment of all outstanding debt for \$7.6 million.

Contractual Obligations and Commitments

The following summarizes our contractual obligations as of December 31, 2013:

	Payments Due by Period			
	Total	Less Than 1 Year	1 - 3 Years (in thousands)	4 - 5 Years More Than 5 Year
Purchase obligations	\$ 10,000	\$ 5,000	\$ 5,000	\$ -
Operating lease obligations	57,822	7,108	18,328	12,667
Total	\$ 67,822	\$ 12,108	\$ 23,328	\$ 12,667

Purchase Obligation

Our purchase obligation represents a non-cancelable royalty-related contractual obligation at December 31, 2013 which is recoupable against future royalty payments.

Off-Balance Sheet Arrangements

As of January 31, 2012 and 2013 and as of December 31, 2012 and 2013, we did not have any off-balance sheet arrangements.

Business 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.

Our results reflect the effects of seasonal trends in listener behavior due to higher advertising sales during the fourth quarter of each calendar year due to greater advertiser demand during the holiday season and lower advertising sales during the first quarter of each calendar year due to seasonally adjusted advertising demand. In addition, we expect to experience increased usage during the fourth quarter of each calendar year due to the holiday season, and in the first quarter of each calendar year due to increased use of media-streaming devices received as gifts during the holiday season. We 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. For example, an advertiser which accounted for more than 10% of our advertising revenue for the three months ended April 30 and July 31, 2011 did not meet this threshold for the three months ended October 31, 2011 and January 31, 2012. 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.

The results of our fiscal quarters (three months ended April 30, July 31, October 31 and January 31 of each year prior to November 1, 2013) reflect the same effects of the seasonal trends on advertising revenue discussed above for calendar periods, except that the impact of these advertising-sales related trends on our fiscal results is not as pronounced due to the inclusion of January instead of October in our fourth fiscal quarter.

We changed our fiscal year to the calendar twelve months ending December 31 to align with the advertising industry's business cycle, effective beginning with the period ended on December 31, 2013. Due to this change, the effect of seasonality on our business will be more pronounced in calendar years ended after December 31, 2013.

The growth in listener hours on mobile and other connected devices was tempered in the eleven months ended December 31, 2013 by the implementation of the mobile listening limit for our advertising supported service on certain mobile and other connected devices. Effective September 2013, we eliminated this limit primarily due to our improved ability to monetize mobile listener hours. Although we have removed the broad 40 hour per month mobile listening limit, we have implemented other more precise measures that we believe will allow us to better manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience. In addition, the mobile listening limit drove significant growth in subscribers to our ad-free service, and since removing the limit we do not expect to experience similar growth in subscriptions in the near term. To the extent we take steps such as these to affect usage on a particular platform, trends in usage may be obscured or changed and comparisons across periods may not be meaningful.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these 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 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 consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the consolidated financial statements.

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

Royalties for Performance Rights of Musical Works

We incur royalty expenses from our public performance of musical works. This includes royalties that we pay for public performance rights to the owners of those musical works or their agents, such as ASCAP, BMI and SESAC. In 2010 and 2012, we elected to terminate our agreements with ASCAP and BMI, respectively. Recent court proceedings, the purported withdrawal of certain performance rights with respect to certain musical works by certain music publishers from the ASCAP and BMI catalogs, and our recent entry into a local marketing agreement to program KXMZ-FM, in part to allow Pandora to qualify for the current ASCAP and BMI license agreements available to owners of one or more commercial radio stations, have highlighted uncertainties for the royalty rates payable to these organizations and to musical copyright owners. We record a liability for public performance royalties based on our best estimate of the amount owed to each licensor, PROs or individual copyright owners, based on historical rates, third-party evidence and legal developments consistent with our past practices. For each quarterly period, we evaluate our estimates to assess the adequacy of recorded liabilities. If actual royalty rates differ from estimates, revisions to the estimated royalty liabilities may be required, which could materially affect our results of operations.

Revenue Recognition

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

Advertising revenue

We generate advertising revenue primarily from audio, display and video advertising. We generate the majority of our advertising revenue through the delivery of advertising impressions sold on a cost per thousand, or CPM, basis. In determining whether an arrangement exists, we ensure that a binding arrangement, such as an insertion order or a fully executed customer-specific agreement, is in place. We generally recognize revenue based on delivery information from our campaign trafficking systems.

We also generate advertising revenue pursuant to arrangements with advertising agencies and brokers. Under these arrangements, we provide the agencies and brokers the ability to sell advertising inventory on our service directly to advertisers. We report this revenue net of amounts due to agencies and brokers because we are not the primary obligor under these arrangements, we do not set the pricing and do not establish or maintain the relationship with the advertisers.

Subscription and other revenue

Subscription and other revenue is generated primarily through the sale of a premium version of the Pandora service which currently includes advertisement-free access and higher audio quality on supported devices. Subscription revenue derived from direct sales to listeners is recognized on a straight-line basis over the duration of the subscription period. Subscription revenue derived from sales through some mobile operating systems 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 reserve. As of December 31, 2013, we had deferred revenue of approximately \$14.2 million related to refund rights. As a result, our revenue results will include a one-time reversal of substantially all of the deferred revenue related to the subscription return reserve in the first quarter of calendar year 2014.

Revenue recognition for multiple-element arrangements

We enter into arrangements with customers to sell advertising packages that include different media placements or ad services that are delivered at the same time, or within close proximity of one another.

We allocate arrangement consideration in multiple-deliverable revenue arrangements at the inception of an arrangement to all deliverables or those packages in which all components of the package are delivered at the same time, based on the relative selling

price method in accordance with the selling price hierarchy, which includes: (1) vendor-specific objective evidence, or VSOE, if available; (2) third-party evidence, or TPE, if VSOE is not available; and (3) best estimate of selling price, or BEBP, if neither VSOE nor TPE is available. BEBP is generally used to allocate the selling price to deliverables in our multiple element arrangements. We determine BEBP for deliverables by considering multiple factors including, but not limited to, prices we charge for similar offerings, sales volume, market conditions, competitive landscape and pricing practices. We recognize the relative fair value of the media placements or ad services as they are delivered assuming all other revenue recognition criteria are met.

Stock-Based Compensation

Stock-based compensation expenses are classified in the statement of operations based on the department to which the related employee reports. Our stock-based awards are comprised principally of stock options and restricted stock unit awards. We measure stock-based compensation expenses for employees at the grant date fair value of the award, and recognize expenses on a straight-line basis over the requisite service period, which is generally the vesting period. We generally estimate the fair value of stock-based payment awards using the Black-Scholes option-pricing model.

The determination of the fair value of a stock-based award on the date of grant using the Black-Scholes option-pricing model is affected by our stock price on the date of grant as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the award, actual and projected employee stock option exercise behaviors, the risk-free interest rate for the expected term of the award and expected dividends. The value of the portion of the award that is ultimately expected to vest is recognized as expense in our statements of operations. Prior to our IPO, our board of directors considered numerous objective and subjective factors to determine the fair market value of our common stock at each meeting at which stock options were granted and approved.

Accounting for Income Taxes

We account for our income taxes 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.

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

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

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks in the ordinary course of our business, including interest rate and inflation risks.

Interest Rate Fluctuation Risk

Our exposure to interest rates relates to the increase or decrease in the amount of interest we must pay on our outstanding debt instruments. In May 2011, we entered into a \$30 million credit facility with a syndicate of financial institutions. In September 2013, we amended this credit facility. The amendment increased the aggregate commitment amount from \$30.0 million to \$60.0 million, extended the maturity date from May 12, 2015 to September 12, 2018 and decreased the interest rate on borrowings. Refer to Note 8 “Debt Instruments” in the Notes to Consolidated Financial Statements for further details regarding our credit facility. Any outstanding borrowings under the credit facility bear a variable interest rate and therefore the interest we pay as well as the fair value of our outstanding borrowings will fluctuate as changes occur in certain benchmark interest rates. As of December 31, 2013, we had no amounts drawn under the credit facility and had \$1.1 million in outstanding letters of credit.

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Approximately 40% of our portfolio consists of cash and cash equivalents that have a relatively short maturity, and a fair value relatively insensitive to interest rate changes. Our available-for-sale investments consist of corporate debt securities, commercial paper and U.S. government and government agency debt securities which may be subject to market risk due to changes in prevailing interest rates that may cause the fair values of our investments to fluctuate. Based on a sensitivity analysis, we have determined that a hypothetical 100 basis points increase in interest rates would have resulted in a decrease in the fair values of our investments of approximately \$2.2 million as of December 31, 2013. Such losses would only be realized if we sold the investments prior to maturity. In future periods, we will continue to evaluate our investment policy in order to ensure that we continue to meet our overall objectives.

Inflation Risk

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

PANDORA MEDIA, INC. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Pandora Media, Inc.

We have audited the accompanying consolidated balance sheets of Pandora Media, Inc. as of January 31, 2013 and December 31, 2013, and the related consolidated statements of operations and comprehensive loss, redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Pandora Media, Inc. at January 31, 2013 and December 31, 2013, and the consolidated results of its operations and its cash flows for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Pandora Media Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated February 14, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Francisco, California
February 14, 2014

Report Of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Pandora Media, Inc.

We have audited Pandora Media, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Pandora Media, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Pandora Media, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pandora Media, Inc. as of January 31, 2013 and December 31, 2013, and the related consolidated statements of operations and comprehensive loss, redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 of Pandora Media, Inc. and our report dated February 14, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Francisco, California
February 14, 2014

Pandora Media, Inc.

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

	As of January 31, 2013	As of December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 65,725	\$ 245,755
Short-term investments	23,247	98,662
Accounts receivable, net of allowance of \$761 at January 31, 2013 and \$1,272 at December 31, 2013	103,410	164,023
Prepaid expenses and other current assets	6,232	10,343
Total current assets	198,614	518,783
Long-term investments	-	105,686
Property and equipment, net	17,758	35,151
Other long-term assets	2,460	13,715
Total assets	<u>\$ 218,832</u>	<u>\$ 673,335</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 4,471	\$ 14,413
Accrued liabilities	7,590	14,885
Accrued royalties	53,083	66,110
Deferred revenue	29,266	42,650
Accrued compensation	21,560	17,948
Total current liabilities	115,970	156,006
Other long-term liabilities	3,873	9,098
Total liabilities	119,843	165,104
Stockholders' equity:		
Common stock, \$0.0001 par value, 1,000,000,000 shares authorized: 172,506,051 shares issued and outstanding at January 31, 2013 and 195,395,940 at December 31, 2013	17	20
Additional paid-in capital	238,552	675,103
Accumulated deficit	(139,574)	(166,591)
Accumulated other comprehensive loss	(6)	(301)
Total stockholders' equity	98,989	508,231
Total liabilities and stockholders' equity	<u>\$ 218,832</u>	<u>\$ 673,335</u>

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

Pandora Media, Inc.

Consolidated Statements of Operations

(In thousands, except per share amounts)

	Twelve months ended January 31,		Eleven months ended December 31,	
	2012	2013	2012	2013
			(unaudited)	
Revenue				
Advertising	\$ 239,957	\$ 375,218	\$ 343,318	\$ 489,340
Subscription and other	34,383	51,927	46,166	110,893
Total revenue	274,340	427,145	389,484	600,233
Cost of revenue				
Cost of revenue - Content acquisition costs	148,708	258,748	230,731	314,866
Cost of revenue - Other	22,759	32,019	28,740	41,844
Total cost of revenue	171,467	290,767	259,471	356,710
Gross profit	102,873	136,378	130,013	243,523
Operating expenses				
Product development	13,425	18,118	16,191	29,986
Sales and marketing	65,010	107,715	94,566	169,774
General and administrative	35,428	48,247	43,320	70,212
Total operating expenses	113,863	174,080	154,077	269,972
Loss from operations	(10,990)	(37,702)	(24,064)	(26,449)
Other income (expense)				
Interest income	59	95	88	96
Interest expense	(616)	(535)	(486)	(554)
Other expense, net	(4,485)	(1)	(3)	(16)
Loss before provision for income taxes	(16,032)	(38,143)	(24,465)	(26,923)
Income tax benefit (expense)	(75)	(5)	3	(94)
Net loss	\$ (16,107)	\$ (38,148)	\$ (24,462)	\$ (27,017)
Accretion of redeemable convertible preferred stock	(110)	-	-	-
Increase in cumulative dividends payable upon conversion or liquidation of redeemable convertible preferred stock	(3,648)	-	-	-
Net loss attributable to common stockholders	(19,865)	(38,148)	(24,462)	(27,017)
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	105,955	168,294	167,956	180,968
Net loss per share, basic and diluted	\$ (0.19)	\$ (0.23)	\$ (0.15)	\$ (0.15)

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

Pandora Media, Inc.

Consolidated Statements of Comprehensive Loss

(In thousands)

	Twelve months ended		Eleven months ended
	January 31,		December 31,
	2012	2013	2013
Net loss	\$ (16,107)	\$ (38,148)	\$ (27,017)
Change in foreign currency translation adjustment	-	(3)	(42)
Change in net unrealized losses on marketable securities	(5)	2	(253)
Other comprehensive loss	(5)	(1)	(295)
Total comprehensive loss	<u>\$ (16,112)</u>	<u>\$ (38,149)</u>	<u>\$ (27,312)</u>

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

Pandora Media, Inc.

Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)

(In thousands, except share amounts)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Other Comprehensive Income (loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Par Amount				
Balances as of January 31, 2011	133,534,334	\$ 126,662	14,510,655	\$ 1	\$ 2,308	\$ —	\$ (85,319)	\$ (83,010)
Issuance of common stock upon exercise of stock options	—	—	5,165,112	1	2,515	—	—	2,516
Stock-based compensation	—	—	—	—	9,187	—	—	9,187
Dividends on redeemable convertible preferred stock	—	25,200	—	—	(25,218)	—	—	(25,218)
Accretion of redeemable convertible preferred stock issuance costs	—	110	—	—	(110)	—	—	(110)
Payment of preferred dividends in connection with initial public offering	—	(31,005)	—	—	—	—	—	—
Conversion of preferred stock to common stock in connection with initial public offering	(133,534,334)	(120,967)	137,294,552	13	126,477	—	—	126,490
Issuance of common stock in connection with initial public offering	—	—	6,350,682	1	90,631	—	—	90,632
Issuance of common stock in connection with preferred stock warrant exercise	—	—	248,360	—	165	—	—	165
Components of comprehensive loss:								
Net loss	—	—	—	—	—	—	(16,107)	(16,107)
Other comprehensive loss	—	—	—	—	—	(5)	—	(5)
Balances as of January 31, 2012	-	\$ -	163,569,361	\$ 16	\$ 205,955	\$ (5)	\$ (101,426)	\$ 104,540
Issuance of common stock upon exercise of stock options	—	—	8,408,842	1	7,305	—	—	7,306
Stock-based compensation	—	—	—	—	25,500	—	—	25,500
Vesting of restricted stock units	—	—	400,112	—	—	—	—	-
Share cancellations to satisfy tax withholding on vesting of restricted stock units	—	—	(18,340)	—	(208)	—	—	(208)
Issuance of common stock in connection with preferred stock warrant exercise	—	—	146,076	—	—	—	—	-
Components of comprehensive loss:								
Net loss	—	—	—	—	—	—	(38,148)	(38,148)
Other comprehensive loss	—	—	—	—	—	(1)	—	(1)
Balances as of January 31, 2013	-	\$ -	172,506,051	\$ 17	\$ 238,552	\$ (6)	\$ (139,574)	\$ 98,989
Issuance of common stock upon exercise of stock options	—	—	5,659,377	1	18,355	—	—	18,356
Issuance of common stock in connection with secondary offering, net issuance costs	—	—	15,730,000	2	378,635	—	—	378,637
Stock-based compensation	—	—	—	—	40,041	—	—	40,041
Vesting of restricted stock units	—	—	1,520,516	—	-	—	—	-
Share cancellations to satisfy tax withholding on vesting of restricted stock units	—	—	(20,004)	—	(480)	—	—	(480)
Components of comprehensive loss:								
Net loss	—	—	—	—	—	—	(27,017)	(27,017)
Other comprehensive loss	—	—	—	—	—	(295)	—	(295)
Balances as of December 31, 2013	-	\$ -	195,395,940	\$ 20	\$ 675,103	\$ (301)	\$ (166,591)	\$ 508,231

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

Pandora Media, Inc.

Consolidated Statements of Cash Flows

(In thousands)

	Twelve months ended January 31,		Eleven months ended December 31,	
	2012	2013	2012	2013
			(unaudited)	
Operating activities				
Net loss	\$ (16,107)	\$ (38,148)	\$ (24,462)	\$ (27,017)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities				
Depreciation and amortization	4,455	7,076	6,406	10,112
Loss on disposition of assets	296	23	23	-
Stock-based compensation	9,187	25,500	23,283	40,041
Remeasurement of preferred stock warrants	4,499	-	-	-
Amortization of premium on investments	246	360	329	237
Amortization of debt issuance costs	190	264	242	220
Changes in assets and liabilities				
Accounts receivable	(24,526)	(36,672)	(43,487)	(60,613)
Prepaid expenses and other assets	156	(3,752)	(2,189)	(7,891)
Accounts payable and accrued liabilities	(865)	4,963	10,419	17,352
Accrued royalties	15,742	19,261	17,525	13,027
Accrued compensation	8,147	9,598	2,085	(3,393)
Deferred revenue	3,322	10,034	10,285	13,384
Reimbursement of cost of leasehold improvements	616	1,243	1,243	1,555
Net cash provided by (used in) operating activities	5,358	(250)	1,702	(2,986)
Investing activities				
Purchases of property and equipment	(11,644)	(7,580)	(11,809)	(21,180)
Purchases of patents	-	-	-	(8,000)
Purchases of investments	(66,890)	(65,168)	(59,559)	(224,549)
Proceeds from maturities of short-term investments	19,984	87,933	79,603	42,210
Payments related to acquisition	-	-	-	(400)
Net cash provided by (used in) investing activities	(58,550)	15,185	8,235	(211,919)
Financing activities				
Borrowings under debt arrangements	-	-	-	10,000
Repayments of debt	(7,596)	-	-	(10,000)
Proceeds from follow-on offering, net of issuance costs	-	-	-	378,654
Proceeds from issuance of common stock	2,074	6,669	5,877	16,793
Proceeds from exercise of preferred stock warrants	165	-	-	-
Proceeds from initial public offering, net	90,632	-	-	-
Payment of dividends to preferred stockholders at initial public offering	(31,005)	-	-	-
Payment of debt issuance costs in connection with the debt refinancing	-	-	-	(450)
Net cash provided by financing activities	54,270	6,669	5,877	394,997
Effects of foreign currency translation	-	(5)	(1)	(62)
Net increase in cash and cash equivalents	1,078	21,599	15,813	180,030
Cash and cash equivalents at beginning of period	43,048	44,126	44,126	65,725
Cash and cash equivalents at end of period	\$ 44,126	\$ 65,725	\$ 59,939	\$ 245,755
Supplemental disclosures of noncash financing activities				
Conversion of preferred stock warrants into common stock warrants	(2,151)	-	-	-
Conversion of preferred stock into common stock	(124,341)	-	-	-
Accruals of preferred stock dividends, net	25,218	-	-	-
Accretion of preferred stock issuance cost	110	-	-	-
Supplemental disclosures of cash flow information				
Cash paid during the period for income taxes	125	-	-	26
Cash paid during the period for interest	887	289	283	18
Purchases of property and equipment recorded in accounts payable and accrued liabilities	-	1,952	726	7,910

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

Pandora Media, Inc.

Notes to Consolidated Financial Statements

1. Description of the Business and Basis of Presentation

Pandora Media, Inc. provides an internet radio service offering a personalized experience for each listener wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. We also offer a paid subscription service which we call Pandora One. We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010.

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

Initial Public Offering

In June 2011, we completed an initial public offering ("IPO") whereby 14,684,000 shares of common stock were sold to the public at a price of \$16.00 per share. We sold 6,000,682 common shares and selling stockholders sold 8,683,318 common shares. In July 2011, in connection with the exercise of the underwriters' overallotment option, 350,000 additional shares of common stock were sold to the public at the initial offering price of \$16.00 per share. We received aggregate proceeds of \$94.5 million from the initial public offering and the underwriters' overallotment option, net of underwriters' discounts and commissions but before deducting offering expenses of \$3.9 million. Upon the closing of the IPO, all shares of our outstanding redeemable convertible preferred stock automatically converted into 137,542,912 shares of common stock and outstanding warrants to purchase redeemable convertible preferred stock automatically converted into warrants to purchase 154,938 shares of common stock.

Follow-on Public Offering

In September 2013, we completed a follow-on public equity offering in which we sold an aggregate of 15,730,000 shares of our common stock, inclusive of 2,730,000 shares sold pursuant to the exercise by the underwriters of an option to purchase additional shares, at a public offering price of \$25.00 per share. In addition, another 5,200,000 shares were sold by certain selling stockholders. We received aggregate net proceeds of \$378.7 million, after deducting underwriting discounts and commissions and offering expenses from sales of our shares in the offering. We did not receive any of the proceeds from the sales of shares by the selling stockholders.

Basis of Presentation

The consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") and include the accounts of Pandora and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of our management, the 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.

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. Our statements of operations now include the presentation of gross profit, which is calculated as total revenue less cost of revenue.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Estimates are used for determining accrued royalties, selling prices for elements sold in multiple-element arrangements, the

allowance for doubtful accounts, stock-based compensation and income taxes. To the extent there are material differences between these estimates, judgments, or assumptions and actual results, our financial statements could be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result.

Segments

Pandora operates in one segment. Our chief operating decision maker (the "CODM"), our Chief Executive Officer, manages our operations on a consolidated basis for purposes of allocating resources. When evaluating our financial performance, the CODM reviews separate revenue information for our advertising, subscription and other offerings, while all other financial information is reviewed on a consolidated basis. All of our principal operations are located in the United States.

Fiscal year

We changed our fiscal year to the calendar twelve months ending December 31, effective beginning with the period ended on December 31, 2013. As a result, our current fiscal period was shortened from twelve months to an eleven-month transition period ended on December 31, 2013. We reported our third fiscal quarter as the three months ended October 31, 2013, followed by a two-month transition period ended December 31, 2013. In these consolidated statements, including the notes thereto, the current year financial results ended December 31, 2013 are for an eleven-month period. Audited results for the twelve months ended January 31, 2012 and 2013 are both for twelve-month periods. In addition, our Consolidated Statements of Operations and Consolidated Statements of Cash Flows include unaudited comparative amounts for the eleven-month period ended December 31, 2012.

All references herein to a fiscal year prior to December 31, 2013 refer to the twelve months ended January 31 of such year, and references to the first, second, third and fourth fiscal quarters ended prior to November 1, 2013 refer to the three months ended April 30, July 31, October 31 and January 31, respectively.

2. Summary of Significant Accounting Policies

Revenue Recognition

Our revenue is principally derived from advertising services and subscription fees. We recognize revenue when: (1) persuasive evidence exists of an arrangement with the customer reflecting the terms and conditions under which products or services will be provided; (2) delivery has occurred or services have been provided; (3) the fee is fixed or determinable; and (4) collection is reasonably assured. For all revenue transactions, we consider a signed agreement, a binding insertion order or other similar documentation to be persuasive evidence of an arrangement.

Advertising revenue. We generate advertising revenue primarily from audio, display and video advertising. We generate the majority of our advertising revenue through the delivery of advertising impressions sold on a cost per thousand, or CPM, basis. In determining whether an arrangement exists, we ensure that a binding arrangement, such as an insertion order or a fully executed customer-specific agreement, is in place. We generally recognize revenue based on delivery information from our campaign trafficking systems.

We also generate advertising revenue pursuant to arrangements with advertising agencies and brokers. Under these arrangements, we provide the agencies and brokers the ability to sell advertising inventory on our service directly to advertisers. We report this revenue net of amounts due to agencies and brokers because we are not the primary obligor under these arrangements, we do not set the pricing and do not establish or maintain the relationship with the advertisers.

Subscription and other revenue. We generate subscription revenue through the sale of a premium version of Pandora internet radio, or Pandora One. Subscription revenue derived from direct sales to listeners is recognized on a straight-line basis over the duration of the subscription period. Subscription revenue derived from sales through some mobile operating systems 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 the service has been provided and the rights lapse or when sufficient transaction history has been developed to estimate a reserve.

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. When refund rights exist, we recognize revenue when the rights lapse or when sufficient transaction history has been developed to estimate a reserve. As of December 31, 2013, we had deferred all revenue subject to certain refund rights totaling approximately \$14.2 million, as we do not currently have sufficient history to estimate a reserve.

Multiple-element arrangements. We enter into arrangements with customers to sell advertising packages that include different media placements or ad services that are delivered at the same time, or within close proximity of one another. We recognize the relative fair value of the media placements or ad services as they are delivered assuming all other revenue recognition criteria are met.

We allocate arrangement consideration in multiple-deliverable revenue arrangements at the inception of an arrangement to all deliverables or those packages in which all components of the package are delivered at the same time, based on the relative selling price method in accordance with the selling price hierarchy, which includes: (1) vendor-specific objective evidence ("VSOE") if available; (2) third-party evidence ("TPE") if VSOE is not available; and (3) best estimate of selling price ("BESP") if neither VSOE nor TPE is available.

VSOE. We determine VSOE based on our historical pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, we require that a substantial majority of the selling prices for these services fall within a reasonably narrow pricing range. We have not historically priced our advertising products within a narrow range. As a result, we have not been able to establish VSOE for any of our advertising products.

TPE. When VSOE cannot be established for deliverables in multiple element arrangements, we apply judgment with respect to whether it can establish a selling price based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our go-to-market strategy differs from that of our peers and our offerings contain a significant level of differentiation such that the comparable pricing of services cannot be obtained. Furthermore, we are unable to reliably determine what similar competitor services' selling prices are on a stand-alone basis. As a result, we have not been able to establish selling price based on TPE.

BESP. When we are unable to establish selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the service were sold on a stand-alone basis. BESP is generally used to allocate the selling price to deliverables in our multiple element arrangements. We determine BESP for deliverables by considering multiple factors including, but not limited to, prices we charge for similar offerings, market conditions, competitive landscape and pricing practices. We limit the amount of allocable arrangement consideration to amounts that are fixed or determinable and that are not contingent on future performance or future deliverables. We regularly review BESP. Changes in assumptions or judgments or changes to the elements in the arrangement may cause an increase or decrease in the amount of revenue that we report in a particular period.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents, investments and trade accounts receivable. We maintain cash and cash equivalents with domestic financial institutions of high credit quality. We perform periodic evaluations of the relative credit standing of such institutions.

We perform ongoing credit evaluations of customers to assess the probability of accounts receivable collection based on a number of factors, including past transaction experience with the customer, evaluation of their credit history, and review of the invoicing terms of the contract. We generally do not require collateral. We maintain reserves for potential credit losses on customer accounts when deemed necessary. Actual credit losses during the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 were \$0.4 million, \$0.5 million and \$0.4 million, respectively.

For the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 we had no customers that accounted for 10% or more of total revenue. As of January 31, 2013 and December 31, 2013, there were no customers that accounted for 10% or more of our total accounts receivable.

Cash, Cash Equivalents and Investments

We classify our highly liquid investments with maturities of three months or less at the date of purchase as cash equivalents. Our investments consist of commercial paper, corporate debt securities and U.S. government and government agency debt securities. These investments are classified as available-for-sale securities and are carried at fair value with the unrealized gains and losses reported as a component of stockholders' equity. Management determines the appropriate classification of our investments at the time of purchase and reevaluates the available-for-sale designations as of each balance sheet date. We classify our investments as either short-term or long-term based on each instrument's underlying contractual maturity date. Investments with maturities of less than twelve months are classified as short-term and those with maturities greater than twelve months are classified as long-term. The cost of investments sold is based upon the specific identification method.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded net of an allowance for doubtful accounts. Our allowance for doubtful accounts is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts. We also consider any changes to the financial condition of our customers and any other external market factors that could impact the collectability of our receivables in the determination of our allowance for doubtful accounts.

Property and Equipment

Property and equipment is recorded at cost, less accumulated depreciation and amortization. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets, which range from three to five years. Leasehold improvements are amortized over the shorter of the lease term or expected useful lives of the improvements.

Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by a comparison of the carrying amounts to the future undiscounted cash flows the assets are expected to generate. If property and equipment are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair market value.

Costs incurred to develop software for internal use are required to be capitalized and amortized over the estimated useful life of the asset if certain criteria are met. Costs related to preliminary project activities and post implementation activities are expensed as incurred. We evaluate the costs incurred during the application development stage of website development to determine whether the costs meet the criteria for capitalization. As of January 31, 2013 and December 31, 2013, we had approximately \$1.1 million and \$1.5 million of capitalized internal use software and website development costs, net of accumulated amortization. These costs are being amortized over their three-year estimated useful lives. Internal use software and website development costs are included in property and equipment.

Preferred Stock Warrant

Prior to the IPO, warrants to purchase our redeemable convertible preferred stock were classified as liabilities on our balance sheet. We measured these warrants at fair value at each balance sheet date and any changes in fair value were recognized as a component of other income (expense) in our statements of operations. Our preferred stock warrants were categorized as Level 3 within the fair value hierarchy because the fair value was estimated using an option valuation model, which included the estimated fair value of the underlying preferred stock at the valuation measurement date, the remaining contractual term of the warrant, risk-free interest rates and expected dividends on and expected volatility of the price of the underlying preferred stock. These assumptions were inherently subjective and involved significant management judgment. We performed the final remeasurement of the warrants at the fair value at the closing date of the IPO on June 20, 2011 because the preferred stock warrants were either exercised or converted to common stock warrants on that date.

We recorded losses of approximately \$4.5 million arising from the revaluation of the convertible preferred stock warrant liability during the twelve months ended January 31, 2012.

Stock-Based Compensation

Stock-based payments made to employees, including grants of employee stock options and restricted stock, are recognized in the statements of operations based on their fair values. We recognize stock-based compensation for awards granted that are expected to vest, on a straight-line basis using the single-option attribution method over the service period of the award, which is generally four years. Because stock-based compensation expenses recognized in the statements of operations are based on awards ultimately expected to vest, they have been reduced for estimated forfeitures. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The forfeiture rates used for valuing stock-based compensation payments were estimated based on historical experience. We generally estimate the fair value of employee stock options using the Black-Scholes valuation model. The determination of the fair value of a stock-based award is affected by the deemed fair value of the underlying stock price on the grant date, as well as other assumptions including the risk-free interest rate, the estimated volatility of our stock price over the term of the award, the estimated period of time that we expect employees to hold their stock options and the expected dividend rate.

We have elected to use the "with and without" approach as described in Accounting Standards Codification 740 *Tax Provisions* in determining the order in which tax attributes are utilized. As a result, we will only recognize a tax benefit from stock-based awards in additional paid-in capital if an incremental tax benefit is realized after all other tax attributes currently available to us have been utilized. In addition, we have elected to account for the indirect effects of stock-based awards on other tax attributes, such as the research tax credit, through the statement of operations.

Cost of Revenue—Content Acquisition Costs

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 and are based on both percentage of revenue and listening metrics. For royalty arrangements under negotiation, we accrue for estimated royalties based on the available facts and circumstances and adjust these estimates as more information becomes available.

Cost of Revenue—Other

Cost of revenue—Other consists primarily of hosting and infrastructure costs and the employee-related costs associated with supporting those functions. Hosting 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 in the period in which the advertising impressions are delivered or click-through actions occur, and accordingly, we record this as a cost of revenue in the related period.

Product Development

Product development consists primarily of employee-related costs, including salaries and benefits related to employees in software engineering, music analysis and product management departments, facilities-related expenses, information technology and costs associated with supporting consumer connected-device manufacturers in implementing our service in their products. We incur product development expenses primarily for improvements to our website and the Pandora app, development of new advertising products and development and enhancement of our personalized station(s) generating system. We have generally expensed product development as incurred.

Certain website development and internal use software development costs may be 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.

Sales and Marketing

Sales and marketing consists primarily of employee-related costs, including salaries, commissions and benefits related to employees in sales, sales support and marketing departments. In addition, sales and marketing expenses include transaction processing fees for subscription purchases on mobile platforms, external sales and marketing expenses such as third-party marketing, branding, advertising and public relations expenses, facilities-related expenses, infrastructure costs and credit card fees.

General and Administrative

General and administrative expenses consists primarily of employee-related costs, consisting of salaries and benefits 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, facilities-related expenses and credit card fees.

Income Taxes

We account for our income taxes 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.

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

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

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, convertible preferred stock warrants, restricted stock units and redeemable convertible preferred stock, to the extent dilutive. Basic and diluted net loss per share were the same for each period presented as the inclusion of all potential common shares outstanding would have been anti-dilutive.

3. Composition of Certain Financial Statement Captions

Cash, Cash Equivalents and Investments

	As of January 31, 2013	As of December 31, 2013
	(in thousands)	
Cash and cash equivalents:		
Cash	\$ 22,703	\$ 89,176
Money market funds	32,522	98,437
Commercial paper	10,500	54,247
Corporate debt securities	—	3,895
Total cash and cash equivalents	<u>\$ 65,725</u>	<u>\$ 245,755</u>
Short-term investments:		
Commercial paper	\$ 13,592	\$ 47,526
Corporate debt securities	9,655	50,436
U.S. government and government agency debt securities	—	700
Total short-term investments	<u>\$ 23,247</u>	<u>\$ 98,662</u>
Long-term investments:		
Corporate debt securities	\$ —	\$ 100,690
U.S. government and government agency debt securities	—	4,996
Total long-term investments	<u>\$ —</u>	<u>\$ 105,686</u>
Cash, cash equivalents and investments	<u><u>\$ 88,972</u></u>	<u><u>\$ 450,103</u></u>

Our short-term investments have maturities of less than twelve months and are classified as available-for-sale. Our long-term investments have maturities of greater than twelve months and are classified as available-for-sale. We did not hold any long-term investments as of January 31, 2013.

The following table summarizes our available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of January 31, 2013 and December 31, 2013.

As of January 31, 2013				
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Money market funds	\$ 32,522	\$ —	\$ —	\$ 32,522
Commercial paper	24,093	—	(1)	24,092
Corporate debt securities	9,657	—	(2)	9,655
Total cash equivalents and marketable securities	<u>\$ 66,272</u>	<u>\$ —</u>	<u>\$ (3)</u>	<u>\$ 66,269</u>
As of December 31, 2013				
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Money market funds	\$ 98,437	\$ —	\$ —	\$ 98,437
Commercial paper	101,773	—	—	101,773
Corporate debt securities	155,273	6	(258)	155,021
U.S. government and government agency debt securities	5,700	—	(4)	5,696
Total cash equivalents and marketable securities	<u>\$ 361,183</u>	<u>\$ 6</u>	<u>\$ (262)</u>	<u>\$ 360,927</u>

The following table presents available-for-sale investments by contractual maturity date as of December 31, 2013. As of January 31, 2013, all of our investments had maturities of less than twelve months.

	<u>As of December 31, 2013</u>	
	<u>Adjusted Cost</u>	<u>Fair Value</u>
	<u>(in thousands)</u>	
Due in one year or less	\$ 255,278	\$ 255,241
Due after one year through three years	105,906	105,686
Total	<u>\$ 361,184</u>	<u>\$ 360,927</u>

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 December 31, 2013 were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of December 31, 2013, we owned 68 securities that were in an unrealized loss position. We do not intend nor expect to need to sell these securities before recovering the associated unrealized losses. We expect to recover the full carrying value of these securities. As a result, no portion of the unrealized losses at December 31, 2013 is deemed to be other-than-temporary and the unrealized losses are not deemed to be credit losses. No available-for-sale securities have been in an unrealized loss position for twelve months or more. When evaluating the investments for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and our intent to sell, or whether it is more likely than not we will be required to sell, the investment before recovery of the investment's amortized cost basis. During the eleven months ended December 31, 2013, we did not recognize any impairment charges.

Accounts Receivable

	<u>As of January 31, 2013</u>	<u>As of December 31, 2013</u>
	<u>(in thousands)</u>	
Accounts receivable	\$ 104,171	\$ 165,295
Allowance for doubtful accounts	(761)	(1,272)
Accounts receivable, net	<u>\$ 103,410</u>	<u>\$ 164,023</u>

The following table summarizes our beginning allowance for doubtful accounts balance for each period, additions, write-offs net of recoveries and the balance at the end of each period for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013:

Allowance for Doubtful Accounts	Balance at Beginning of Period	Additions	Write-offs, Net of Recoveries	Balance at End of Period
		(in thousands)		
For the twelve months ended January 31, 2012	\$ 503	\$ 492	\$ (405)	\$ 590
For the twelve months ended January 31, 2013	590	659	(488)	761
For the eleven months ended December 31, 2013	761	948	(437)	1,272

Property and Equipment

	As of January 31, 2013	As of December 31, 2013
	(in thousands)	
Property and equipment:		
Software developed for internal use	\$ 1,095	\$ 2,173
Servers, computers and other related equipment	19,461	27,361
Office furniture and equipment	1,722	2,248
Construction in progress	2,264	13,575
Leasehold improvements	6,142	11,314
Total property and equipment	\$ 30,684	\$ 56,671
Less accumulated depreciation and amortization	(12,926)	(21,520)
Property and equipment, net	\$ 17,758	\$ 35,151

Depreciation and amortization expenses totaled \$4.5 million and \$7.1 million for the twelve months ended January 31, 2012 and 2013 and \$10.1 million for the eleven months ended December 31, 2013. We wrote off net assets due to asset retirement totaling \$0.3 million for the twelve months ended January 31, 2012. There were no material write-offs during the twelve months ended January 31, 2013 or the eleven months ended December 31, 2013.

Software developed for internal use generally has an expected useful life of three years from the date placed in service. As of January 31, 2013 and December 31, 2013 the net carrying amount was \$1.0 million and \$1.5, including accumulated amortization of \$0.1 million and \$0.7 million. Amortization expense for the twelve months ended January 31, 2013 and the eleven months ended December 31, 2013 was \$0.1 million and \$0.6 million. We held no material software developed for internal use assets during the twelve months ended January 31, 2012.

4. Fair Value

We record cash equivalents and 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.

As of January 31, 2013			
Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
	(in thousands)		
Assets:			
Money market funds	\$ 32,522	\$ —	\$ 32,522
Commercial paper	—	24,092	24,092
Corporate debt securities	—	9,655	9,655
Total assets measured at fair value	\$ 32,522	\$ 33,747	\$ 66,269

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

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 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. During the twelve months ended January 31, 2013 and the eleven months ended December 31, 2013, we held no Level 3 assets.

5. Other Long-Term Assets

	As of January 31, 2013	As of December 31, 2013
	(in thousands)	
Other long-term assets:		
Patents, net of amortization	\$ -	\$ 7,636
Long-term security deposits	922	4,736
Other	709	1,343
Restricted cash	829	-
Total other long-term assets	\$ 2,460	\$ 13,715

In June 2013, we purchased certain internet radio-related patents from Yahoo! Inc. for \$8.0 million in cash. We intend to hold these patents as part of our strategy to protect and defend Pandora from patent-related litigation. These patents are being amortized over a period of eleven years.

As part of our original May 2011 credit facility, we had entered into a cash collateral agreement in connection with the issuance of letters of credit that were used to satisfy deposit requirements under facility leases, refer to Note 8 “Debt Instruments” for more information. In September 2013, we amended the credit facility and terminated the cash collateral agreement. As a result, our outstanding letters of credit no longer required cash collateral and all cash collateral that was considered restricted cash was returned to us in September 2013.

Pending Acquisition

In June 2013, we entered into a local marketing agreement to program KXMZ-FM, a Rapid City, South Dakota-area terrestrial radio station. In addition, we entered into an agreement to purchase the assets of KXMZ-FM for a total purchase price of approximately \$0.6 million in cash, subject to certain closing conditions. As of December 31, 2013, we have paid \$0.4 million of the purchase price, which is included in the other long-term assets line item of our balance sheets.

The completion of the KXMZ-FM acquisition is subject to various closing conditions, which include, but are not limited to, regulatory approval by the Federal Communications Commission. Upon completion of these conditions, we expect to account for this transaction as a business combination.

6. Commitments and Contingencies

Leases

The following is a schedule of future minimum lease payments under operating leases as of December 31, 2013:

	Twelve months ended December 31, (in thousands)
2014	\$ 7,108
2015	9,169
2016	9,159
2017	8,004
2018	4,663
Thereafter	19,719
Total future minimum lease payments	<u>\$ 57,822</u>

We conduct our operations using leased office facilities in various locations. We lease office space under arrangements expiring through 2024. Rent expenses for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 were \$2.5 million, \$3.2 million and \$5.7 million, respectively.

For operating leases that include escalation clauses over the term of the lease, tenant improvement reimbursements and rent abatement periods, we recognize rent expense on a straight-line basis over the lease term including expected renewal periods. The difference between rent expense and rent payments is recorded as deferred rent in current and long-term liabilities. As of January 31, 2013 and December 31, 2013 deferred rent was \$3.6 million and \$9.4 million.

Purchase Obligation

As of December 31, 2013, we had a non-cancelable royalty-related contractual obligation which is recoupable against future royalty payments. As of December 31, 2013, the balance of this purchase obligation was \$10.0 million.

Indemnification Agreements, Guarantees and Contingencies

In the ordinary course of business, we are party to certain contractual agreements under which it 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.

Legal Proceedings

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

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

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

On September 10, 2012, B.E. Technology, LLC filed suit against Pandora in the United States District Court for the Western District of Tennessee alleging that we infringe a B.E. Technology patent and seeking injunctive relief and monetary damages. We filed our answer on December 31, 2012. Defendants in other suits in which B.E. Technology is plaintiff have filed inter partes review petitions before the U.S. Patent and Trademark Office challenging the validity of the patent Pandora is alleged to have infringed. The trial court granted Pandora's motion to stay this litigation until the inter partes review has been concluded.

On November 26, 2012, 1st Technology LLC filed suit against Pandora in the U.S. District Court for the Northern District of Illinois alleging patent infringement. The complaint seeks injunctive relief and monetary damages. On November 20, 2013, the parties negotiated mutually acceptable terms of a settlement of the case. On November 21, 2013, the court dismissed the complaint with prejudice, granting the plaintiff leave to refile if a written settlement agreement is not signed. The parties fully executed a settlement agreement and release on December 2, 2013.

On February 26, 2013, Macrosolve, Inc. filed suit against Pandora in the U.S. District Court for the Eastern District of Texas alleging that Pandora infringes a Macrosolve, Inc. patent and seeks injunctive relief and monetary damages. On December 3, 2013, the parties negotiated mutually acceptable terms of a settlement of the case. On January 2, 2014, the court entered a final judgment of dismissal.

On December 23, 2013, Operative Media, Inc. filed a complaint in the New York Supreme Court for New York County alleging that Pandora failed to pay invoices when due, failed to cooperate, and anticipatorily breached a software subscription contract. Pandora's responsive pleading was filed in February 2014.

We currently believe that Pandora has substantial and meritorious defenses to the claims in the lawsuits discussed above and intends to vigorously defend our position.

We are also subject to legal proceedings involving musical work royalty rates. On November 5, 2012, we filed a petition in the rate court established by the consent decree between the American Society of Composers, Authors and Publishers ("ASCAP") and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. On June 11, 2013 we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights ASCAP could license on behalf of such publishers subsequent to the date of our request for a license from ASCAP were not valid as to our ASCAP consent decree license. On September 17, 2013, our motion for partial summary judgment was granted, alleviating the need to negotiate direct licenses for such purportedly withdrawn performance rights. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014.

On June 13, 2013, Broadcast Music, Inc. ("BMI") filed a petition in the rate court established by the consent decree between BMI and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2017. We filed our response on July 19, 2013. On November 1, 2013, we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights BMI could license on behalf of such publishers subsequent to the date of our request for a license from BMI were not valid as to our BMI consent decree license. On December 18, 2013, our motion for summary judgment was denied.

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

7. Income Taxes

Income (loss) before income taxes by jurisdiction consists of the following:

	Twelve months ended January 31,		Eleven months ended December 31,
	2012	2013 (in thousands)	2013
Jurisdiction:			
Domestic	\$ (15,802)	\$ (39,891)	\$ (24,005)
Foreign	(230)	1,748	(2,918)
Income (loss) before income taxes	(16,032)	(38,143)	(26,923)

The provision for income tax expense consists of the following:

	Twelve months ended January 31,		Eleven months ended December 31,
	2012	2013 (in thousands)	2013
Current:			
Federal	\$ —	\$ —	\$ —
State and local	75	(4)	7
International	—	9	87
Total current income tax expense	\$ 75	\$ 5	\$ 94
Deferred:			
Federal	\$ (403)	\$ (10,098)	\$ (10,166)
State and local	(1,457)	(1,573)	(2,027)
Valuation allowance	1,860	11,671	12,193
Total deferred income tax expense	\$ -	\$ -	\$ -
Total income tax expense	\$ 75	\$ 5	\$ 94

The income tax provision increased by \$0.1 million during the eleven months ended December 31, 2013 as a result of an increase in foreign taxes.

The following table presents a reconciliation of the statutory federal rate and our effective tax rate:

	Twelve months ended January 31,		Eleven months ended December 31,
	2012	2013	2013
U.S. federal taxes at statutory rate	34 %	34 %	34 %
State taxes, net of federal benefit	-	-	-
Permanent differences	(24)	(2)	5
Foreign rate differential	-	(2)	(4)
Federal and state credits, net of reserve	2	2	8
Change in valuation allowance	(16)	(30)	(46)
Change in rate	1	(2)	-
Other	3	-	3
Effective tax rate	- %	- %	- %

The major components of deferred tax assets and liabilities consist of the following:

	As of January 31, 2013	As of December 31, 2013
	(in thousands)	
Deferred tax assets:		
Net operating loss carryforwards	\$ 36,056	\$ 34,525
Tax credit carryforwards	3,027	5,745
Allowances and other	3,371	7,037
Stock options	4,313	10,159
Depreciation and amortization	257	323
Total deferred tax assets	\$ 47,024	\$ 57,789
Deferred tax liabilities:		
Depreciation and amortization	(1,469)	(41)
Total deferred tax liabilities	\$ (1,469)	\$ (41)
Valuation allowance	(45,555)	(57,748)
Net deferred tax assets	\$ -	\$ -

At December 31, 2013, we had federal net operating loss carryforwards of approximately \$264.2 million and tax credit carryforwards of approximately \$5.3 million. If realized, approximately \$179.6 million of the net operating loss carryforwards will be recognized as a benefit through additional paid in capital. The federal net operating losses and tax credits expire in years beginning in 2021. At December 31, 2013, we had state net operating loss carryforwards of approximately \$245.2 million which expire in years beginning in 2014. In addition, we had state tax credit carryforwards of approximately \$5.1 million that do not expire and approximately \$2.3 million of credits that will expire beginning in 2024.

Under Section 382 and 383 of the Internal Revenue Code of 1986, as amended, or the Code, if a corporation undergoes an "ownership change," the corporation's ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes, such as research tax credits, to offset its post-change income may be limited. In general, an "ownership change" will occur if there is a cumulative change in our ownership by "5-percent shareholders" that exceeds 50 percentage points over a rolling three-year period. Similar rules may apply under state tax laws. Utilization of our net operating loss and tax credit carryforwards may be subject to annual limitations due to ownership changes. Such annual limitations could result in the expiration of our net operating loss and tax credit carryforwards before they are utilized.

During the eleven months ended December 31, 2013 our valuation allowance increased by \$12.2 million. At January 31, 2013 and December 31, 2013, we maintained a full valuation allowance on our net deferred tax assets. The valuation allowance was determined in accordance with the provisions of ASC 740, Accounting for Income Taxes, which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction by jurisdiction basis. Our history of cumulative losses, along with expected future U.S. losses required that a full valuation allowance be recorded against all net deferred tax assets. We intend to maintain a full valuation allowance on net deferred tax assets until sufficient positive evidence exists to support reversal of the valuation allowance.

At January 31, 2013 and December 31, 2013 we have unrecognized tax benefits of approximately \$2.6 million and \$5.2 million, respectively. The increase in our unrecognized tax benefits was primarily attributable to current year activities. The total unrecognized tax benefits, if recognized, would not affect our effective tax rate as the tax benefit would increase a deferred tax asset, which is currently offset with a full valuation allowance. We do not anticipate that the amount of existing unrecognized tax benefits will significantly increase or decrease within the next twelve months. Accrued interest and penalties related to unrecognized tax benefits are recorded as income tax expenses. We did not have such interest, penalties or tax benefits during the twelve months ended January 31, 2012 or 2013 or the eleven months ended December 31, 2013.

We file income tax returns in the United States, California, other states and international jurisdictions. Tax years 2000 to 2013 remain subject to examination for U.S. federal, state and international purposes. All net operating losses and tax credits generated to date are subject to adjustment for U.S. federal and state purposes. We are not currently under examination in any federal, state or international jurisdictions.

8. Debt Instruments

In May 2011, we entered into a \$30.0 million credit facility with a syndicate of financial institutions. At our option, drawn amounts under the credit facility bore an interest rate of either an adjusted London Interbank Offered Rate, or LIBOR, plus 2.75% - 3.00% or an alternate base rate plus 1.75% - 2.00%, both of which were per annum rates based on outstanding borrowings. Adjusted LIBOR is LIBOR for a particular interest period multiplied by the statutory reserve rate. The alternate base rate is the greatest of the prime rate, the federal funds effective rate plus 0.5% and adjusted LIBOR plus 1%. In addition, the credit facility included a non-usage charge on the available balance of 0.5% - 0.625% per annum based on outstanding borrowings. Under the credit facility, we could request the issuance of up to \$5.0 million in letters of credit by the financial institutions. The annual charge for any outstanding letters of credit was 2.75% - 3.00% per annum based on outstanding borrowings.

In September 2013, we amended this credit facility. The amendment increased the aggregate commitment amount from \$30.0 million to \$60.0 million and extended the maturity date from May 12, 2015 to September 12, 2018. The amendment further decreased the interest rate on borrowings by 0.75% to either LIBOR plus 2.00% - 2.25% or an alternate base rate plus 1.00% - 1.25%, both of which are per annum rates based on outstanding borrowings. In addition, the amendment decreased the non-usage fee to 0.375% per annum. The amount of available letters of credit under the amended credit facility was increased from \$5.0 million to \$15.0 million and the annual charge for outstanding letters of credit was reduced by 0.75% to 2.00% - 2.25% per annum based on outstanding borrowings.

The amount of borrowings available under the credit facility at any time is based on our monthly accounts receivable balance at such time and the amounts borrowed are collateralized by our personal property, including such accounts receivable but excluding intellectual property. The credit facility contains customary events of default, conditions to borrowing and covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur debt, incur liens and make distributions to stockholders. The credit facility also includes a financial covenant requiring the maintenance of minimum liquidity of at least \$5.0 million. During the continuance of an event of a default, the lenders may accelerate amounts outstanding, terminate the credit facility and foreclose on all collateral.

As part of the original credit facility, we had entered into a cash collateral agreement in connection with the issuance of letters of credit that were used to satisfy deposit requirements under facility leases. Under the amended credit facility, the cash collateral agreement was terminated and, as a result, letters of credit no longer require cash collateral. In connection with the termination of the cash collateral agreement, all cash collateral that was considered restricted cash was returned to us in September 2013.

In July 2013, we borrowed approximately \$10.0 million from the credit facility to enhance our working capital position. This amount was paid off in full in August 2013. As of December 31, 2013 we had no borrowings outstanding, \$1.1 million in letters of credit outstanding and \$58.9 million of available borrowing capacity under the credit facility.

As of January 31, 2013, we had no borrowings outstanding, \$0.8 million in letters of credit outstanding and \$29.2 million of available borrowing capacity under the credit facility. As of January 31, 2013, \$0.8 million in cash collateral for letters of credit was considered to be restricted cash and was included in other-long term assets.

Total debt issuance costs associated with the May 2011 credit facility were \$1.0 million, which were amortized as interest expense over the four-year term of the May 2011 credit facility agreement. As part of the amendment, the amortization period for the remaining unamortized costs incurred in connection with the May 2011 credit facility was adjusted to reflect the amended term of the credit facility. We further incurred \$0.5 million in debt issuance costs in connection with the amendment, which are being amortized over the term of the amended credit facility. For the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 \$0.2 million, \$0.3 million and \$0.2 million of debt issuance costs, respectively, were amortized and included in interest expense.

9. Stock-based Compensation Plans and Awards

Stock Compensation Plans

In 2000, our board of directors adopted the 2000 Stock Incentive Plan, as amended (the "2000 Plan"). In 2004, our board of directors adopted the 2004 Stock Option Plan (the "2004 Plan"), which replaced the 2000 Plan and provided for the issuance of incentive and non-statutory stock options to employees and other service providers of Pandora. In 2011, our board of directors adopted the Pandora Media, Inc. 2011 Equity Incentive Plan (the "2011 Plan" and, together with the 2000 Plan and the 2004 Plan, the "Plans"), which replaced the 2004 plan. The Plans are administered by the compensation committee of our board of directors (the "Plan Administrator").

The 2011 Plan provides for the issuance of stock options, restricted stock units and other stock-based awards. Shares of common stock reserved for issuance under the 2011 Plan include 12,000,000 shares of common stock reserved for issuance under the 2011 Plan and 1,506,424 shares of common stock previously reserved but unissued under the 2004 Plan as of June 14, 2011. To the extent awards outstanding as of June 14, 2011 under the 2004 Plan expire or terminate for any reason prior to exercise or would otherwise return to the share reserve under the 2004 Plan, the shares of common stock subject to such awards will instead be available for future issuance under the 2011 Plan. Each year, the number of shares in the reserve under the Plan may be increased by the lesser of 10,000,000 shares, 4.0% of the outstanding shares of common stock on the last day of the prior fiscal year or another amount determined by our board of directors. The 2011 Plan is scheduled to terminate in 2021, unless our board of directors determines otherwise.

Under the 2011 Plan, the Plan Administrator determines various terms and conditions of awards including option expiration dates (no more than ten years from the date of grant), vesting terms (generally over a four-year period) and payment terms. For stock option grants the exercise price is determined by the Plan Administrator, but generally may not be less than the fair market value of the common stock on the date of grant.

Valuation of Awards

The per-share fair value of each stock option was determined on the date of grant using the Black-Scholes option pricing model using the following assumptions:

	Twelve months ended		Eleven months ended
	January 31,		December 31,
	2012	2013	2013
Expected life (in years)	5.72 - 7.02	6.02 - 6.67	5.99-6.32
Risk-free interest rate	1.10% - 2.77%	0.99% - 1.52%	1.00%-2.04%
Expected volatility	54% - 57%	56% - 57%	58%-59%
Expected dividend yield	0%	0%	0%

The expected term of stock options granted represents the weighted average period that the stock options are expected to remain outstanding. We determined the expected term assumption based on our historical exercise behavior combined with estimates of the post-vesting holding period. Expected volatility is based on historical volatility of peer companies in our industry that have similar vesting and contractual terms. The risk free interest rate is based on the implied yield currently available on U.S. Treasury issues with terms approximately equal to the expected life of the option. We currently have no history or expectation of paying cash dividends on our common stock.

Common Stock

Each share of common stock has the right to one vote per share. The holders of common stock are also entitled to receive dividends as and when declared by our board of directors, whenever funds are legally available. These rights are subordinate to the dividend rights of holders of all classes of stock outstanding at the time.

Stock Options

Stock option activity during the eleven months ended December 31, 2013 was as follows:

	Options Outstanding				
	Shares Available for Grant	Outstanding Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate(1) Intrinsic Value
	(in thousands, except share and per share data)				
Balance as of January 31, 2013	17,791,314	26,102,949	\$ 3.22	6.40	\$ 224,736
Additional shares authorized	-				
Granted	(2,915,000)	2,915,000	16.67		
Restricted stock units	(6,374,319)				
Exercised	-	(5,763,544)	3.14		
Cancelled/Forfeited	546,205	(546,205)	8.11		
Balance as of December 31, 2013	9,048,200	22,708,200	4.85	5.76	\$ 493,866
Exercisable as of December 31, 2013		15,432,372	1.50	4.56	\$ 387,296
Vested as of December 31, 2013 and expected to vest thereafter (2)		21,914,709	4.58	5.67	\$ 482,571

(1) Amounts represent the difference between the exercise price and the fair value of common stock at each period end for all in the money options outstanding based on the fair value per share of common stock of \$11.52 and \$26.60 as of January 31, 2013 and December 31, 2013, respectively.

(2) Options expected to vest reflect an estimated forfeiture rate.

As of December 31, 2013, there was \$40.1 million of unrecognized compensation cost related to outstanding employee stock options. This amount is expected to be recognized over a weighted-average period of 3.03 years. To the extent the actual forfeiture rate is different from what we have estimated, stock-based compensation related to these awards will be different from our expectations.

The per-share fair value of stock options granted to non-employees is determined on the date of grant using the Black-Scholes option pricing model with the same assumptions as those used for employee awards with the exception of expected term. The expected term for non-employee awards is the contractual term of 10 years.

As of January 31, 2013 and December 31, 2013, a total of 52,000 and 30,270 common stock options, issued to non-employees were vested and outstanding. During the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013, we recorded \$0.3 million, \$0.2 million and \$0.6 million in stock-based compensation expenses related to stock option grants made to non-employees, respectively. As of December 31, 2013, total compensation cost related to stock options granted to non-employees but not yet recognized, was \$0.3 million, which we expect to recognize over a weighted-average period of 0.95 years. The fair value of these options will be remeasured on each vesting date and as of each reporting date until the options vest. The remeasured fair value will be recognized as compensation expense over the remaining vesting term of the options.

Early Exercise Liability

Certain of our options granted prior to the IPO provided the right to exercise those options before they are vested. We have a right to repurchase any unvested shares at a repurchase price equal to the exercise price during the 90-day period following the termination of an individual's service with Pandora for any reason.

In connection with the early exercise of stock options, we have the right, but not the obligation, to repurchase unvested shares of common stock upon termination of the individual's service with Pandora at the original purchase price per share. As of January 31, 2013 and December 31, 2013, 308,334 and 80,209 unvested restricted shares of common stock were subject to repurchase. During the eleven months ended December 31, 2013 there were 104,167 shares repurchased at the previous early exercise price of \$3.14 per share.

During the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 there were no early exercises. Repurchase rights with respect to the restricted shares outstanding as of December 31, 2013 will expire ratably by January 31, 2015.

Stock Option Awards with Both a Service Period and a Market Condition

In March 2012, Mr. Joseph Kennedy, the Company's Chief Executive Officer, was granted non-statutory stock options to purchase 800,000 shares of common stock with an exercise price of \$10.63 per share. This award included both a service period and a market vesting condition that stipulated that the award would vest if the 60-day trailing volume weighted average price of our common stock exceeded \$21.00 per share, or if there was a sale of the Company for at least \$21.00 per share, in each case prior to July 2017. Upon the market condition being met, the award would vest ratably over four years, beginning in July 2013, subject to severance and change of control acceleration.

We used a Monte Carlo simulation to value the award due to the market vesting condition. The following assumptions were used to value the award using the Monte Carlo simulation: 10-year term, risk-free interest rate of 2.33%, expected volatility of 70% and a beginning stock price of \$10.63. The grant-date fair value for the award was \$6.08 per share.

In March 2013, we announced that we would begin a process to identify a successor to Mr. Kennedy as CEO, which prompted us to re-evaluate certain estimates and assumptions related to the stock-based compensation expense associated with his awards. As a result of this re-evaluation, we reduced stock-based compensation expense by \$1.7 million during the three months ended April 30, 2013, primarily related to the award with both a service period and a market condition. In September 2013, the market condition for Mr. Kennedy's awards was met and the shares became exercisable as if they had been vesting ratably over four years from July 2013. In the eleven months ended December 31, 2013, we recorded \$0.6 million in additional stock-based compensation expense in connection with these awards.

Modification of Awards

During the twelve months ended January 31, 2012, we revised our employment policies for certain eligible officers, resulting in a modification of approximately 3.6 million stock options held by these employees. As a result, upon an involuntary termination, any unvested options or other stock awards scheduled to vest within a defined time frame would be accelerated. The modification of these stock options resulted in approximately \$0, \$2.3 million and \$0.8 million, in incremental stock-based compensation expense for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013, respectively.

Restricted Stock Units

During the eleven months ended December 31, 2013, we granted 7,129,868 restricted stock units ("RSUs") under the 2011 Plan at a weighted average fair value of \$16.16 per share. The fair value of the restricted stock units is expensed ratably over the vesting period. RSUs generally vest annually on a cliff basis over the service period, which is generally four years. During the eleven months ended December 31, 2013, we recorded stock-based compensation expense related to restricted stock units of approximately \$28.9 million. As of December 31, 2013, total compensation cost not yet recognized of approximately \$129.6 million related to non-vested restricted stock units, is expected to be recognized over a weighted average period of 2.97 years.

The following table summarizes the activities for our RSUs for the eleven months ended December 31, 2013:

	Number of RSUs	Weighted- Average Grant-Date Fair Value
Unvested at January 31, 2013	5,511,709	\$ 10.57
Granted	7,129,868	16.16
Vested	(1,520,516)	10.77
Canceled	(755,549)	11.68
Unvested at December 31, 2013	10,365,512	\$ 14.31
Vested as of December 31, 2013 and expected to vest thereafter (1)	11,075,193	\$ 13.73

(1) Options expected to vest reflect an estimated forfeiture rate.

Stock-based Compensation Expenses

The weighted-average fair value of stock option grants made during the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 was \$4.83, \$5.91 and \$9.34 per share. As of December 31, 2013, total compensation cost related to stock options granted, but not yet recognized, was \$40.1 million, which we expect to recognize over a weighted-average period of approximately 3.03 years.

The total grant date fair value of stock options vested during the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 was \$5.0 million, \$13.0 million and \$9.1 million, respectively.

The aggregate intrinsic value of options and warrants exercised during the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 was \$51.9 million, \$84.9 million and \$93.8 million, respectively. The total fair value of options vested during the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013 was \$5.2 million, \$13.1 million and \$9.4 million, respectively.

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

	Twelve months ended		Eleven months ended
	January 31,		December 31,
	2012	2013	2013
	(in thousands)		
Stock-based compensation expenses:			
Cost of revenue - Other	\$ 582	\$ 1,214	\$ 1,946
Product development	1,638	4,530	8,802
Sales and marketing	4,866	12,294	20,222
General and administrative	2,101	7,462	9,071
Total stock-based compensation, recorded in costs and expenses	\$ 9,187	\$ 25,500	\$ 40,041

During the eleven months ended December 31, 2013, we capitalized \$0.7 million of stock-based compensation as internal use software and website development costs.

10. Redeemable Convertible Preferred Stock

Redeemable Convertible Series G Preferred Stock

Redeemable convertible preferred stock was as follows as of the closing date of our IPO:

	<u>Shares Authorized</u>	<u>Shares Issued and Outstanding</u>	<u>Carrying Value</u>	<u>Aggregate Liquidation Preference</u>	<u>Accumulated Dividends</u>	<u>Cumulative Aggregate Liquidation Preference</u>
	(in thousands, except share data)					
Series A	375,000	375,000	\$ 1,500	\$ 1,500	\$ —	\$ 1,500
Series B	24,859,899	24,859,899	14,777	9,362	5,356	14,718
Series C	24,060,786	23,884,315	17,561	12,181	5,398	17,579
Series D	21,878,271	21,812,963	35,601	25,050	9,961	35,011
Series E	8,639,737	8,639,737	18,257	14,694	2,849	17,543
Series F	45,988,020	45,833,082	40,131	35,498	5,509	41,007
Series G	8,250,000	8,129,338	24,145	22,250	1,932	24,182
	<u>134,051,713</u>	<u>133,534,334</u>	<u>\$ 151,972</u>	<u>\$ 120,535</u>	<u>\$ 31,005</u>	<u>\$ 151,540</u>

During the period from February 1, 2011 through the closing date of our IPO, we accrued dividends of \$3.6 million on our redeemable convertible preferred stock. Upon the closing of the IPO on June 20, 2011, all outstanding redeemable convertible preferred stock was converted into shares of common stock at the contractual conversion ratios per the relevant redeemable preferred stock purchase agreements. Subsequent to our IPO, there are no further convertible preferred share dividends as all outstanding convertible preferred stock has been converted. On the closing date of the IPO we paid \$30.6 million in dividends to the holders of redeemable convertible preferred stock.

Accretion of Redeemable Convertible Preferred Stock

Stock issuance costs were being accreted via a charge to accumulated deficit over the period from the date of issuance of the redeemable convertible preferred stock to the date at which the redeemable convertible preferred stock became redeemable at the option of the holders of the redeemable convertible preferred stock, the date of our IPO.

11. Common Stock and Net Loss Per Share

Each share of common stock has the right to one vote per share. The holders of common stock are also entitled to receive dividends as and when declared by our board of directors, whenever funds are legally available. These rights are subordinate to the dividend rights of holders of all classes of stock outstanding at the time.

Basic net loss per share is computed by dividing the net loss attributable to common stockholders 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, convertible preferred stock warrants and redeemable convertible preferred stock, to the extent dilutive. Basic and diluted net loss per share was the same for each year presented as the inclusion of all potential common shares outstanding would have been anti-dilutive.

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

	Twelve months ended January 31,		Eleven months ended December 31,
	2012	2013	2013
	(in thousands, except per share data)		
Numerator:			
Net loss	\$ (16,107)	\$ (38,148)	\$ (27,017)
Accretion of redeemable convertible preferred stock	(110)	-	-
Increase in cumulative dividends payable upon conversion or liquidation of redeemable convertible preferred stock	(3,648)	-	-
Net loss attributable to common stockholders	<u>\$ (19,865)</u>	<u>\$ (38,148)</u>	<u>\$ (27,017)</u>
Denominator:			
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	105,955	168,294	180,968
Net loss per share, basic and diluted	<u>\$ (0.19)</u>	<u>\$ (0.23)</u>	<u>\$ (0.15)</u>

Net loss was increased by the cumulative dividends payable upon conversion or liquidation of redeemable convertible preferred shares earned in the twelve months ended January 31, 2012 to arrive at net loss attributable to common stockholders. For the twelve months ended January 31, 2012 dividends were accrued up through the conversion at the close of the IPO.

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

	Twelve months ended January 31,		Eleven months ended December 31,
	2012	2013	2013
	(in thousands)		
Options to purchase common stock	34,811	26,103	22,708
Warrants to purchase common stock	155	-	-
Restricted stock units	1,427	5,512	10,366
Total common stock equivalents	<u>36,393</u>	<u>31,615</u>	<u>33,074</u>

12. Selected Quarterly Financial Data (unaudited)

	Three months ended							Two months ended
	April 30, 2012	July 31, 2012	Oct 31, 2012	Jan 31, 2013	April 30, 2013	July 31, 2013	Oct 31, 2013	Dec 31, 2013 ⁽¹⁾
	(in thousands, except per share data)							
Total revenue	\$ 80,784	\$ 101,267	\$ 120,005	\$ 125,089	\$ 125,510	\$ 157,355	\$ 180,376	\$ 136,992
Cost of revenue:								
Cost of Revenue—Content acquisition costs	55,818	60,522	65,713	76,695	82,853	81,880	86,989	63,144
Cost of revenue—Other	6,917	7,514	8,338	9,250	9,779	11,037	12,423	8,605
Total cost of revenue	62,735	68,036	74,051	85,945	92,632	92,917	99,412	71,749
Gross profit	18,049	33,231	45,954	39,144	32,878	64,438	80,964	65,243
Operating expenses:								
Product development	4,119	4,475	4,371	5,153	7,033	7,926	8,848	6,179
Sales and marketing	23,460	23,457	26,714	34,084	40,083	45,794	50,575	33,322
General and administrative	10,612	10,602	12,700	14,333	14,209	18,352	23,038	14,613
Total operating expenses	38,191	38,534	43,785	53,570	61,325	72,072	82,461	54,114
Income (loss) from operations	(20,142)	(5,303)	2,169	(14,426)	(28,447)	(7,634)	(1,497)	11,129
Net income (loss) attributable to common stockholders	\$ (20,228)	\$ (5,415)	\$ 2,052	\$ (14,557)	\$ (28,587)	\$ (7,787)	\$ (1,700)	\$ 11,057
Net income (loss) per share, basic and diluted	\$ (0.12)	\$ (0.03)	\$ 0.01	\$ (0.09)	\$ (0.16)	\$ (0.04)	\$ (0.01)	\$ 0.06

(1) We are using this report to transition to a quarterly reporting cycle that corresponds to a December 31 fiscal year end. Therefore, for financial reporting purposes our fourth quarter of the current fiscal year was shortened from the three months ended January 31 to the two months ended December 31.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

ITEM 9A. 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 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 Transition Report on Form 10-K, 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 December 31, 2013.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of internal control effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management has assessed the effectiveness of the internal control over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control—Integrated Framework (1992 framework). Based on this evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2013.

The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included in this Transition Report on Form 10-K.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during our most recent transition period that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information required by this Item regarding our directors and executive officers is incorporated by reference to the sections of our proxy statement to be filed with the SEC in connection with our 2014 annual meeting of stockholders (the "Proxy Statement") entitled "Election of Class III Directors" and "Management."

Information required by this Item regarding our corporate governance, including our audit committee and code of business conduct and ethics, is incorporated by reference to the sections of the Proxy Statement entitled "Corporate Governance" and "Board of Directors."

Information required by this Item regarding compliance with Section 16(a) of the Exchange Act required by this Item is incorporated by reference to the section of the Proxy Statement entitled "Section 16(a) Beneficial Ownership Reporting Compliance."

Item 11. EXECUTIVE COMPENSATION

Information required by this Item is incorporated by reference to the sections of the Proxy Statement entitled "Executive Compensation," "Board of Directors—Compensation of Directors," "Corporate Governance—Compensation Committee Interlocks and Insider Participation."

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding security ownership of certain beneficial owners and management is incorporated by reference to the section of the Proxy Statement entitled "Security Ownership of Certain Beneficial Owners and Management."

Information regarding our stockholder approved and non-approved equity compensation plans is incorporated by reference to the section of the Proxy Statement entitled "Equity Compensation Plan Information."

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this Item is incorporated by reference to the sections of the Proxy Statement entitled "Certain Relationships and Related Party Transactions" and "Corporate Governance—Director Independence."

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this Item is incorporated by reference to the section of the Proxy Statement entitled "Ratification of Appointment of Independent Registered Public Accounting Firm."

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are included as part of this Transition Report on Form 10-K.

1. Index to Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of January 31, 2013 and December 31, 2013

Consolidated Statements of Operations for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013

Consolidated Statements of Comprehensive Loss for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013

Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit) for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2013

Consolidated Statements of Cash Flows for the twelve months ended January 31, 2012 and 2013 and the eleven months ended December 31, 2012 and 2013

Notes to Consolidated Financial Statements

2. Financial Statement Schedule

All other schedules are omitted as the information required is inapplicable or the information is presented in the consolidated financial statements or the related notes.

3. Exhibits

See the Exhibit Index immediately following the signature page of this Transition Report on Form 10-K.

SIGNATURES

Pursuant to the requirements Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 14, 2014.

PANDORA MEDIA, INC.

By: /s/ BRIAN MCANDREWS

Name: Brian McAndrews
Title: *Chief Executive Officer,
President and Chairman of the
Board*

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints Brian McAndrews, Mike Herring and Delida Costin and each of them, his or her true and lawful attorneys-in-fact and agents, with full power to act separately and full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Transition Report on Form 10-K, and to file the same, with all exhibits thereto, and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto each said attorney-in-fact and agent full power and authority to do and perform each and every act in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or either of them or his or her or their substitute or substitutes may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1934, as amended, this report has been signed by the following persons in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ BRIAN MCANDREWS</u> Brian McAndrews	Chief Executive Officer, President and Chairman of the Board (Principal Executive Officer)	February 14, 2014
<u>/s/ MICHAEL S. HERRING</u> Michael S. Herring	Chief Financial Officer (Principal Financial and Accounting Officer)	February 14, 2014
<u>/s/ PETER CHERNIN</u> Peter Chernin	Director	February 14, 2014
<u>/s/ JAMES M. P. FEUILLE</u> James M. P. Feuille	Director	February 14, 2014
<u>/s/ PETER GOTCHER</u> Peter Gotcher	Director	February 14, 2014
<u>/s/ ROBERT KAVNER</u> Robert Kavner	Director	February 14, 2014

<u>/s/ ELIZABETH A. NELSON</u> Elizabeth A. Nelson	Director	February 14, 2014
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<u>/s/ DAVID SZE</u> David Sze	Director	February 14, 2014
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<u>/s/ TIM WESTERGREN</u> Tim Westergren	Director	February 14, 2014
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EXHIBIT INDEX

Exhibit No.	Exhibit Description	Incorporated by Reference					Filed Herewith
		Form	File No.	Exhibit	Filing Date	Filed By	
3.01	Amended and Restated Certificate of Incorporation	S-1/A	333-172215	3.1	5/4/2011		
3.02	Amended and Restated Bylaws	S-1/A	333-172215	3.2	5/4/2011		
4.01	Fifth Amended and Restated Investor Rights Agreement, by and among Pandora Media, Inc. and the investors listed on Exhibit A thereto, dated May 20, 2010, as amended	S-1/A	333-172215	4.2	2/22/2011		
10.01 †	2011 Long Term Incentive Plan and Form of Stock Option Agreement under 2011 Long Term Incentive Plan	S-1/A	333-172215	10.1	5/26/2011		
10.02 †	2011 Corporate Incentive Plan	S-1/A	333-172215	10.2	5/4/2011		
10.03 †	2004 Stock Plan, as amended, and Forms of Stock Option Agreement and Restricted Stock Purchase Agreement under 2004 Stock Plan	S-1/A	333-172215	10.3	2/22/2011		
10.04 †	2000 Stock Incentive Plan, as amended, and Forms of NSO Stock Option Agreement and ISO Stock Option Agreement under 2000 Stock Plan	S-1/A	333-172215	10.4	2/22/2011		
10.05 †	Form of Indemnification Agreement by and between Pandora Media, Inc. and each of its executive officers and its directors not affiliated with an investment fund	S-1/A	333-172215	10.5	2/22/2011		
10.06 †	Form of Indemnification Agreement by and between Pandora Media, Inc. and each of its directors affiliated with an investment fund	S-1/A	333-172215	10.5A	2/22/2011		
10.7 †	Offer Letter with Joseph Kennedy, dated July 7, 2004.	S-1/A	333-172215	10.6	2/22/2011		
10.8 †	Employment Agreement with Tim Westergren, dated April 28, 2004	S-1/A	333-172215	10.7	2/22/2011		
10.9 †	Offer Letter with Steven Cakebread, dated February 23, 2010	S-1/A	333-172215	10.8	2/22/2011		
10.10 †	Offer Letter with Thomas Conrad, dated November 12, 2004	S-1/A	333-172215	10.9	2/22/2011		
10.11 †	Offer Letter with John Trimble, dated February 18, 2009	S-1/A	333-172215	10.1	2/22/2011		
10.12	Office Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated July 23, 2009	S-1/A	333-172215	10.12	2/22/2011		
10.12A	First Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated April 13, 2010	S-1/A	333-172215	10.12A	2/22/2011		
10.12B	Second Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated June 16, 2010	S-1/A	333-172215	10.12B	2/22/2011		
10.12C	Third Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated December 15, 2010	10-Q	001-35198	10.12C	9/4/2012		
10.12D	Fourth Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated March 10, 2011	10-Q	001-35198	10.12D	9/4/2012		
10.12E	Fifth Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated July 1, 2011	10-Q	001-35198	10.12E	9/4/2012		
10.12F	Sixth Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated September 27, 2011	10-Q	001-35198	10.12F	9/4/2012		
10.12G	Seventh Amendment to Lease between CIM/Oakland Center 21, LP and Pandora Media, Inc., dated July 12, 2012	10-Q	001-35198	10.12G	9/4/2012		

Exhibit No.	Exhibit Description	Incorporated by Reference					Filed Herewith
		Form	File No.	Exhibit	Filing Date	Filed By	
10.13	Web Site Performance Agreement by and between Broadcast Music, Inc. and Savage Beast Technologies, Inc., dated June 30, 2005	S-1/A	333-172215	10.13	2/22/2011		
10.14	License Agreement by and between SESAC and Pandora Media, Inc., dated July 1, 2007	S-1/A	333-172215	10.14	2/22/2011		
10.15	Credit Agreement among Pandora Media, Inc., the Lenders party thereto and JPMorgan Chase Bank, N.A. as Administrative Agent, dated as of May 13, 2011	S-1/A	333-172215	10.17	6/10/2011		
10.15A	Amendment and Restatement Agreement to Credit Agreement among Pandora Media, Inc., the Lenders party thereto and JPMorgan Chase Bank, N.A. as Administrative Agent, dated as of September 12, 2013	10-Q	001-35198	10.15	11/26/2013		
10.16 †	Form of Restricted Stock Unit Agreement under the 2011 Equity Incentive Plan	10-Q	001-35198	10.01	9/2/2011		
10.17 †	Amended Executive Severance and Change in Control Policy	10-K	001-35198	10.18	3/19/2012		
10.18 †	Offer Letter with Simon Fleming-Wood, dated August 5, 2012	10-Q	001-35198	10.19	6/4/2012		
10.19 †	2013 Corporate Incentive Plan	10-Q	001-35198	10.20	6/4/2012		
10.19B†	2014 Corporate Incentive Plan	10-Q	001-35198	10.19B	8/26/2013		
10.20 †	Stock Option Agreement with Joseph Kennedy, dated March 22, 2012	10-Q	001-35198	10.21	6/4/2012		
10.21 †	Transition Agreement with Steven Cakebread, dated August 29, 2012	10-Q	001-35198	10.22	12/7/2012		
10.22 †	Australian Form of Restricted Stock Unit Agreement under the 2011 Equity Incentive Plan	10-K	001-35198	10.22	3/18/2013		
10.23 †	Offer Letter with Michael Herring, dated December 21, 2012	10-K	001-35198	10.23	3/18/2013		
10.24†	New Zealand Form of Restricted Stock Unit Agreement under the 2011 Equity Incentive Plan	10-Q	001-35198	10.24	5/29/2013		
10.25†	Offer Letter with Brian McAndrews, dated September 11, 2013	10-Q	001-35198	10.25	11/26/2013		
23.01	Consent of Independent Registered Public Accounting Firm						X
24.01	Power of Attorney (included on signature page of this Transition Report on Form 10-K)						X
31.01	Certification of the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act						X
31.02	Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act						X
32.01	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act						X
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Balance Sheets as of December 31, 2013 and January 31, 2013, (ii) Condensed Statements of Operations for the Eleven months ended December 31, 2013 and 2012 and the Twelve months ended January 31, 2013 and 2012, (iii) Condensed Statements of Comprehensive Loss for the Eleven months Ended December 31, 2013 and the Twelve months ended January 31, 2013 and 2012, (iv) Condensed Statements of Cash Flows for the Eleven months ended December 31, 2013 and 2012 and the Twelve months ended January 31, 2013 and 2012 and (v) Notes to Condensed Financial Statements						X

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 333-175378, Form S-8 No. 333-182212, Form S-8 No. 333-187340) pertaining to the 2000 Stock Incentive Plan, 2004 Stock Plan and 2011 Equity Incentive Plan of Pandora Media, Inc. of our reports dated February 14, 2014, with respect to the consolidated financial statements of Pandora Media, Inc. and the effectiveness of internal control over financial reporting of Pandora Media, Inc. included in this Transition Report (Form 10-K) for the eleven months ended December 31, 2013.

/s/ Ernst & Young LLP

San Francisco, California
February 14, 2014

**Certification of Principal Executive Officer
Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

I, Brian McAndrews, certify that:

1. I have reviewed this Transition Report on Form 10-K of Pandora Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 14, 2014

/s/ Brian McAndrews

Name: Brian McAndrews

Title: *Chief Executive Officer, President and Chairman of the Board (Principal Executive Officer)*

**Certification of Principal Financial Officer
Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

I, Michael S. Herring, certify that:

1. I have reviewed this Transition Report on Form 10-K of Pandora Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 14, 2014

/s/ Michael S. Herring

Name: Michael S. Herring

Title: *Executive Vice President and Chief Financial Officer
(Principal Financial Officer)*

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF SARBANES-OXLEY ACT OF 2002**

The certification set forth below is being submitted in connection with this Transition Report on Form 10-K for the eleven months ended December 31, 2013 (the “Report”) for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Each of the undersigned certifies that, to his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Pandora Media, Inc.

February 14, 2014

/s/ Brian McAndrews

Name: Brian McAndrews

Title: *Chief Executive Officer, President and Chairman of the Board (Principal Executive Officer)*

/s/ Michael S. Herring

Name: Michael S. Herring

Title: *Executive Vice President and Chief Financial Officer (Principal Financial Officer)*

This certification accompanying the Report is not deemed filed with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities such Section, and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before, on or after the date of the Report), irrespective of any general incorporation language contained in such filing.

The background of the image is a dark navy blue. It is decorated with numerous circles of varying sizes and shades of blue. Some circles are a vibrant cyan, while others are a lighter, hazy blue, creating a bokeh-like effect. The circles are scattered across the entire frame, with some appearing more prominent than others.

PANDORA®

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

FORM 10-Q

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

For the quarterly period ended March 31, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 001-35198

Pandora Media, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

**2101 Webster Street, Suite 1650
Oakland, CA**

(Address of principal executive offices)

94-3352630

(I.R.S. Employer
Identification No.)

94612

(Zip Code)

(510) 451-4100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ 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 April 24, 2014 was: 205,451,005.

Pandora Media, Inc.
FORM 10-Q Quarterly Report
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Pandora Media, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except share and per share amounts)
(Unaudited)

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

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

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

	Three months ended March 31,	
	2013 (recast)	2014
Revenue		
Advertising	\$ 96,714	\$ 140,634
Subscription and other	18,410	53,681
Total revenue	115,124	194,315
Cost of revenue		
Cost of revenue - Content acquisition costs	85,823	108,275
Cost of revenue - Other	9,776	14,979
Total cost of revenue	95,599	123,254
Gross profit	19,525	71,061
Operating expenses		
Product development	6,667	11,831
Sales and marketing	38,045	61,864
General and administrative	13,355	26,361
Total operating expenses	58,067	100,056
Loss from operations	(38,542)	(28,995)
Other income (expense)		
Interest income	16	218
Interest expense	(144)	(129)
Other income (expense), net	1	3
Loss before provision for income taxes	(38,669)	(28,903)
Income tax expense	(17)	(28)
Net loss	\$ (38,686)	\$ (28,931)
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	172,733	199,857
Net loss per share, basic and diluted	\$ (0.22)	\$ (0.14)

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

Pandora Media, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2013 (recast)	2014
Net loss	\$ (38,686)	\$ (28,931)
Change in foreign currency translation adjustment	(4)	19
Change in net unrealized losses on marketable securities	3	114
Other comprehensive loss	(1)	133
Total comprehensive loss	<u>\$ (38,687)</u>	<u>\$ (28,798)</u>

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

Pandora Media, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2013 (recast)	2014
Operating activities		
Net loss	\$ (38,686)	\$ (28,931)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	2,034	3,346
Stock-based compensation	6,524	17,392
Amortization of premium on investments	60	694
Amortization of debt issuance costs	66	49
Changes in assets and liabilities		
Accounts receivable	3,647	15,703
Prepaid expenses and other assets	(1,143)	(5,212)
Accounts payable and accrued liabilities	1,911	1,401
Accrued royalties	9,353	8,585
Accrued compensation	(4,065)	(735)
Deferred revenue	7,422	(14,527)
Net cash used in operating activities	<u>(12,877)</u>	<u>(2,235)</u>
Investing activities		
Purchases of property and equipment	(4,318)	(11,774)
Purchases of investments	(13,365)	(115,589)
Proceeds from maturities of investments	18,830	34,010
Net cash provided by (used in) investing activities	<u>1,147</u>	<u>(93,353)</u>
Financing activities		
Proceeds from employee stock purchase plan	—	863
Proceeds from issuance of common stock	4,033	9,751
Net cash provided by financing activities	<u>4,033</u>	<u>10,614</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(6)</u>	<u>15</u>
Net decrease in cash and cash equivalents	(7,703)	(84,959)
Cash and cash equivalents at beginning of period	59,939	245,755
Cash and cash equivalents at end of period	<u>\$ 52,236</u>	<u>\$ 160,796</u>

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

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Pandora Media, Inc. provides an internet radio service offering a personalized experience for each listener wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. We also offer a paid subscription service which we call Pandora One. We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010.

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

Basis of Presentation

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) and include the accounts of Pandora and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of our management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of our financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in our Transition Report on Form 10-K for the eleven months ended December 31, 2013.

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

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. Our statements of operations now include the presentation of gross profit, which is calculated as total revenue less cost of revenue. In addition, we have reclassified certain software license fees, facilities-related expenses and depreciation expenses among the general and administrative, cost of revenue — other, sales and marketing and product development lines in our condensed consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Estimates are used for determining accrued royalties, selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, stock-based compensation, income taxes and the subscription return reserve. To the extent there are material differences between these estimates, judgments, or assumptions and actual results, our financial statements could be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP and does not require management’s judgment in its application. There are also areas in which management’s judgment in selecting among available alternatives would not produce a materially different result.

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

2. Summary of Significant Accounting Policies

Other than discussed below, there have been no material changes to our significant accounting policies as compared to those described in our Transition Report on Form 10-K for the eleven months ended December 31, 2013.

Stock-Based Compensation — Employee Stock Purchase Plan

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

Deferred Revenue

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

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

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

Concentration of Credit Risk

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

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

3. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments consisted of the following:

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

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

The following tables summarize our available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of December 31, 2013 and March 31, 2014.

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

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

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

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

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

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

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

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

4. Fair Value

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

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

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

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

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

The fair value of these financial assets and liabilities was determined using the following inputs at December 31, 2013 and March 31, 2014:

As of December 31, 2013			
Fair Value Measurement Using			
Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total	
(in thousands)			
Assets:			
Money market funds	\$ 98,437	\$ —	\$ 98,437
Commercial paper	—	101,773	101,773
Corporate debt securities	—	155,021	155,021
U.S. government and government agency debt securities	—	5,696	5,696
Total assets measured at fair value	\$ 98,437	\$ 262,490	\$ 360,927
As of March 31, 2014			
Fair Value Measurement Using			
Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total	
(in thousands)			
Assets:			
Money market funds	\$ 90,531	\$ —	\$ 90,531
Commercial paper	—	82,424	82,424
Corporate debt securities	—	201,869	201,869
U.S. government and government agency debt securities	—	10,941	10,941
Total assets measured at fair value	\$ 90,531	\$ 295,234	\$ 385,765

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, 2013 and March 31, 2014, we held no Level 3 assets or liabilities.

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

5. Commitments and Contingencies

Legal Proceedings

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

In June 2011, a putative class action lawsuit was filed against Pandora in the United States District Court for the Northern District of California alleging that we unlawfully accessed and transmitted personally identifiable information of the plaintiffs in connection with their use of our Android mobile application. In addition to civil liability, the amended complaint includes allegations of violations of statutes under which criminal penalties could be imposed if we were found liable. Our motion to dismiss the first amended complaint was granted on March 26, 2013. The plaintiff filed a second amended complaint in May 2013, which contains allegations similar to those contained in the previous complaint. On March 10, 2014, our motion to dismiss was granted in part and denied in part.

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

On September 10, 2012, B.E. Technology, LLC filed suit against Pandora in the United States District Court for the Western District of Tennessee alleging that we infringe a B.E. Technology patent and seeking injunctive relief and monetary damages. We filed our answer on December 31, 2012. Defendants in other suits in which B.E. Technology is plaintiff have filed inter partes review petitions before the U.S. Patent and Trademark Office challenging the validity of the patent Pandora is alleged to have infringed. The trial court granted Pandora's motion to stay this litigation until the inter partes review has been concluded.

On December 23, 2013, Operative Media, Inc. filed a complaint in the New York Supreme Court for New York County alleging that Pandora failed to pay invoices when due, failed to cooperate, and anticipatorily breached a software subscription contract. Pandora's responsive pleading was filed in February 2014. The court entered a final judgment of dismissal on April 23, 2014.

We currently believe that Pandora has substantial and meritorious defenses to the claims in the lawsuits discussed above and intends to vigorously defend our position.

We are also subject to legal proceedings involving musical work royalty rates. On November 5, 2012, we filed a petition in the rate court established by the consent decree between the American Society of Composers, Authors and Publishers ("ASCAP") and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. On June 11, 2013 we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain

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rights of public performance by digital audio transmission from the scope of grant of rights ASCAP could license on behalf of such publishers subsequent to the date of our request for a license from ASCAP were not valid as to our ASCAP consent decree license. On September 17, 2013, our motion for partial summary judgment was granted, alleviating the need to negotiate direct licenses for such purportedly withdrawn performance rights. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014 and the court issued its opinion in March 2014.

On June 13, 2013, Broadcast Music, Inc. (“BMI”) filed a petition in the rate court established by the consent decree between BMI and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2017. We filed our response on July 19, 2013. On November 1, 2013, we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights BMI could license on behalf of such publishers subsequent to the date of our request for a license from BMI were not valid as to our BMI consent decree license. On December 18, 2013, our motion for summary judgment was denied.

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 performance of sound recordings recorded prior to February 15, 1972.

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

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.

Pandora Media, Inc.**Notes to Condensed Consolidated Financial Statements — Continued****6. Other Long-Term Assets**

	As of December 31, 2013	As of March 31, 2014
	(in thousands)	

Other long-term assets:		
Patents, net of amortization	\$ 7,636	\$ 7,455
Long-term security deposits	4,736	4,853
Other	1,343	1,552
Total other long-term assets	<u>\$ 13,715</u>	<u>\$ 13,860</u>

Pending Acquisition

In June 2013, we entered into a local marketing agreement to program KXMZ-FM, a Rapid City, South Dakota-area terrestrial radio station. In addition, we entered into an agreement to purchase the assets of KXMZ-FM for a total purchase price of approximately \$0.6 million in cash, subject to certain closing conditions. As of March 31, 2014, we have paid \$0.4 million of the purchase price, which is included in the other long-term assets line item of our balance sheets.

The completion of the KXMZ-FM acquisition is subject to various closing conditions, which include, but are not limited to, regulatory approval by the Federal Communications Commission. Upon completion of these conditions, we expect to account for this acquisition as a business combination.

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

7. Debt Instruments

We are party to a \$60.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. The interest rate on borrowings is either LIBOR plus 2.00% - 2.25% or an alternate base rate plus 1.00% - 1.25%, both of which are per annum rates based on outstanding borrowings. The amount of borrowings available under the credit facility at any time is based on our monthly accounts receivable balance at such time, and the amounts borrowed are collateralized by our personal property (including such accounts receivable but excluding intellectual property). Under the credit facility, we can request up to \$15.0 million in letters of credit be issued by the financial institutions.

The credit facility contains customary events of default, conditions to borrowing and covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur debt, incur liens and make distributions to stockholders. The credit facility also includes a financial covenant requiring the maintenance of minimum liquidity of at least \$5.0 million. During the continuance of an event of a default, the lenders may accelerate amounts outstanding, terminate the credit facility and foreclose on all collateral.

As of March 31, 2014, we had no borrowings outstanding, \$1.1 million in letters of credit outstanding and \$58.9 million of available borrowing capacity under the credit facility.

Pandora Media, Inc.**Notes to Condensed Consolidated Financial Statements - Continued****8. Stock-based Compensation Plans and Awards***Employee Stock Purchase Plan*

In December 2013, our board of directors approved the Employee Stock Purchase Plan (“ESPP”), subject to approval at the annual meeting of stockholders in June 2014. The ESPP allows eligible employees to purchase shares of our common stock through payroll deductions of up to 15% of their eligible compensation, subject to a maximum of \$25,000 per calendar year. Shares reserved for issuance under the ESPP include 4,000,000 shares of common stock. The ESPP provides for six-month offering periods, with the first offering period commencing in February 2014. At the end of each offering period employees are able to purchase shares at 85% of the lower of the fair market value of our common stock on the first trading day of the offering period or on the last day of the offering period.

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

The per-share fair value of shares granted under the ESPP was determined on the first day of the offering period using the Black-Scholes option pricing model using the following assumptions:

	Three months ended March 31,	
	2013	2014
Expected life (in years)	N/A	0.5
Risk-free interest rate	N/A	0.08%
Expected volatility	N/A	42%
Expected dividend yield	N/A	0%

During the three months ended March 31, 2014, we withheld \$0.9 million in contributions from employees and recognized \$0.3 million of stock-based compensation expense related to the ESPP. No shares of common stock were issued under the ESPP for the three months ended March 31, 2014.

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 March 31, 2013 and 2014, we recorded stock-based compensation expense from stock options of approximately \$1.7 million and \$3.5 million.

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The per-share fair value of each stock option was determined on the grant date using the Black-Scholes option pricing model using the following assumptions:

	Three months ended March 31,	
	2013	2014
Expected life (in years)	5.99 - 6.32	6.08
Risk-free interest rate	0.99 - 1.19%	1.71 - 1.82%
Expected volatility	57 - 58%	59%
Expected dividend yield	0%	0%

Restricted stock units

The fair value of the restricted stock units (“RSUs”) is expensed ratably over the vesting period. RSUs vest annually on a cliff basis over the service period, which is generally four years. During the three months ended March 31, 2013 and 2014, we recorded stock-based compensation expense from RSUs of approximately \$4.8 million and \$13.6 million.

Stock-based Compensation Expense

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

	Three months ended March 31,	
	2013	2014
	(in thousands) (unaudited)	
Stock-based compensation expense:		
Cost of revenue - Other	\$ 413	\$ 881
Product development	1,445	3,461
Sales and marketing	4,421	8,311
General and administrative	245	4,739
Total stock-based compensation expense	<u>\$ 6,524</u>	<u>\$ 17,392</u>

Pandora Media, Inc.**Notes to Condensed Consolidated Financial Statements - Continued****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 and restricted stock units, to the extent dilutive. Basic and diluted net loss per share were the same for the three months ended March 31, 2013 and 2014, as the inclusion of all potential common shares outstanding would have been anti-dilutive.

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

	Three months ended March 31,	
	2013	2014
(in thousands except per share amounts)		
Numerator:		
Net loss	\$ (38,686)	\$ (28,931)
Denominator:		
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	172,733	199,857
Net loss per share, basic and diluted	\$ (0.22)	\$ (0.14)

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

	Three months ended March 31,	
	2013	2014
(in thousands)		
Options to purchase common stock	26,047	13,518
Restricted stock units	7,886	11,752
Total common stock equivalents	33,933	25,270

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 Transition Report on Form 10-K for the eleven months ended December 31, 2013 filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act").

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

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 Transition Report on Form 10-K for the eleven months ended December 31, 2013. 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 is the leader in internet radio in the United States, offering a personalized experience for each of our listeners wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements.

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As of March 31, 2014, we had more than 250 million registered users, and more than 200 million registered users had accessed Pandora through smartphones and tablets. For the three months ended March 31, 2014, we streamed 4.80 billion hours of radio, and as of March 31, 2014, we had 75.3 million active users during the prior 30 day period. According to a January 2014 report by Triton, we have more than a 70% share of internet radio among the top 20 stations and networks in the United States. Since we launched our free, advertising-supported radio service in 2005 our listeners have created over 6 billion stations.

At the core 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 100,000 artists, spanning over 500 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 or genre to start a station, the Pandora service instantly generates a station that plays music we think that listener will enjoy. Based on listener reactions to the songs we stream, we further tailor the station to match the listener's preferences in real time

We currently provide the Pandora service through two models:

- *Free Service.* Our free service is advertising-based 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 provided to paying subscribers without any external advertising. Pandora One enables listeners to create more stations, have more daily skips and enjoy higher quality audio on supported devices.

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 traditional computers, we have developed Pandora mobile device applications or "apps" for smartphones such as iPhone, Android, the Windows Phone and the iPhone and for tablets including the iPad and Android tablets. We distribute those mobile apps free to listeners via app stores. In addition, Pandora is now integrated with more than 1,000 connected devices, including automobiles, automotive aftermarket devices and consumer electronic devices.

Recent Events

In November 2012, we filed a petition in the rate court established by the consent decree between ASCAP and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014, and in March 2014, the court issued its opinion establishing a royalty rate of 1.85% of revenue for the entire license period. This opinion did not have a material impact on our consolidated statements of operations. For the three months ended March 31, 2014, we incurred content acquisition costs for the public performance of musical works, including those we pay to other performing rights organizations such as BMI and SESAC, representing approximately 4% of our total revenue. Refer to "Factors Affecting our Business Model" below for further details regarding royalties paid to performing rights organizations.

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Effective in March 2014, we implemented a change in the pricing structure for Pandora One under which the \$36 annual subscription option was eliminated. In addition, effective in May 2014, the monthly pricing option for Pandora One will be increased to \$4.99 per month for new subscribers. Existing monthly subscribers who do not lapse will maintain the current \$3.99 per-month pricing structure, and existing annual subscribers who do not lapse will be migrated to the current monthly pricing structure.

In February 2014, Triton received Media Rating Council (“MRC”) accreditation for its Webcast Metrics Local (“WCML”) product, which allows agencies and advertisers to evaluate Pandora’s relative audience scale using broadcast metrics in specific advertising markets. Also in February 2014, we completed the WCML publisher audit of our user-declared geographic and demographic listener data. We believe this accreditation validates that our local audience metrics are reliable and effective.

Factors Affecting our Business Model

As our mobile listenership increases, we face new challenges in optimizing our advertising products for delivery on mobile and other connected device platforms and monetizing inventory generated by listeners using these platforms. The mobile digital advertising market is at an early stage of development, with lower overall spending levels than traditional online advertising markets, and faces technical challenges due to fragmented platforms and lack of standard audience measurement protocols. As a greater share of our listenership is consumed on mobile devices, our ability to monetize increased mobile streaming may not keep up with our past monetization of streaming to desktop computers and laptops.

In addition, our strategy includes increasing the number of ad campaigns for traditional computer, mobile and other connected device platforms sold to local advertisers, placing us in more direct competition with broadcast radio for advertiser spending, especially for audio advertisements. By contrast, historically our display advertisers have been predominantly national brands. To successfully monetize our growing listener hours, we may have 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, and in particular, audio advertising products, across the range of our delivery platforms.

Growth in our active users and distribution platforms has fueled a corresponding growth in listener hours. Our total number of listener hours is a key driver for both revenue generation opportunities and content acquisition 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. In turn, our ability to generate revenue depends on the extent to which we are able to sell the inventory we have.
- *Cost of Revenue—Content Acquisition Costs.* The number of sound recordings we transmit to users of the Pandora service, as generally reflected by listener hours, drives substantially all 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.

We pay royalties to the copyright owners, or their agents, of each sound recording that we stream and to the copyright owners, or their agents, of the musical work embodied in that sound recording, subject to certain exclusions. Royalties for sound recordings are negotiated with and paid to record labels or to SoundExchange, a performing rights organization (“PRO”) authorized to collect royalties on behalf of all sound recording copyright owners. Royalties for musical works are most often negotiated with and paid to PROs such as ASCAP, BMI and SESAC or directly to publishing companies such as Sony/ATV. Royalties are calculated based on the number of sound recordings streamed, revenue earned or other usage measures.

We stream spoken word comedy content pursuant to a federal statutory license, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization or the copyright owner of such content. However, we pay royalties to SoundExchange at rates negotiated between representatives of online music services and SoundExchange for the right to stream this spoken word comedy content.

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Given the current royalty structures in effect through 2015 with respect to the public performance of sound recordings in the United States, 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 depends on our ability to increase our revenue per hour of streaming through increased advertising sales across all of our delivery platforms.

In addition, we expect to invest heavily in our operations to support anticipated future growth. One of our key objectives is furthering our market leadership in internet radio, 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. For the foreseeable future, we expect that there will be periods during which our ability to monetize listener hours will lag behind the growth of listener hours. As our business matures, we expect that the growth rate in our listener hours will decline relative to our increased ability to monetize listener hours. However, we expect to incur annual net losses on a U.S. GAAP basis in the near term.

Our current strategy is to leverage any improvements in gross profit by investing in broadening distribution channels, developing innovative and scalable advertising products, increasing utilization of advertising inventory and building our sales force. These investments are intended to drive further growth in our business through both increased listener hours and monetization of those hours, and as a result we are targeting gradual improvements in gross profit over time. Our planned reinvestment of any resulting incremental gross profit will continue to depress any growth of bottom line profitability.

Key Metrics

Listener Hours

The table below sets forth our listener hours for the three months ended March 31, 2013 and 2014.

	Three months ended March 31,	
	2013	2014
	(in billions)	
Listener hours	4.26	4.80

We track listener hours because it is a key indicator of the growth of our business. 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. 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.

Active Users

The table below sets forth our active users as of December 31, 2013 and March 31, 2014.

	As of December 31, 2013	As of March 31, 2014
	(in millions)	
Active users	76.2	75.3

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We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time. Active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts.

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

The table below sets forth our ad RPMs, including total, traditional computer and mobile and other connected devices ad RPMs for the three months ended March 31, 2013 and 2014.

	Three months ended March 31,	
	2013	2014
Total ad RPMs	\$ 24.85	\$ 33.40
Traditional computer	44.63	52.75
Mobile and other connected devices	20.43	29.46

We track ad RPMs for our free, advertising supported service because it is a key indicator of our ability to monetize advertising inventory created by our listener hours. We focus on total ad RPMs across all of our delivery platforms. Ad RPMs compare advertising revenue generated in a given period to advertising supported listener hours in the period and we believe such total ad RPMs to be the central top-line indicator for evaluating the results of our monetization efforts. We calculate total ad RPMs by dividing advertising revenue we generate by the number of thousands of listener hours of our advertising-based service.

We also provide estimates of disaggregated ad RPMs for our traditional computer platform as well as our mobile and other connected devices platforms, which we calculate by dividing the estimated advertising revenue generated through the respective platforms by the number of thousands of listener hours of our advertising-based service delivered through such platforms. While we believe that such disaggregated ad RPMs provide directional insight for evaluating our efforts to monetize our service by platform, we do not validate disaggregated ad RPMs to the level of financial statement reporting. Such metrics should be seen as indicative only and as management's best estimate. We continue to refine our systems and methodologies used to categorize ad RPMs across our delivery platforms. 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.

Total ad RPMs.

For the three months ended March 31, 2013 compared to 2014, total ad RPMs increased as advertising sales growth outpaced the growth in advertising-supported listener hours primarily due to an increase in the average price per ad.

Traditional computer ad RPMs.

For the three months ended March 31, 2013 compared to 2014, traditional computer ad RPMs increased as the growth in traditional computer revenue outpaced the growth in listener hours on that platform primarily due to an increase in the average price per traditional computer ad.

[Table of Contents](#)*Mobile and other connected device ad RPMs.*

For the three months ended March 31, 2013 compared to 2014, mobile and other connected device ad RPMs increased as the growth in mobile and other connected devices revenue outpaced the growth in listening hours on those platforms due to an increase in the average price per mobile ad.

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

The table below sets forth our total RPMs, including total, traditional computer and mobile and other connected devices total RPMs for the three months ended March 31, 2013 and 2014.

	Three months ended March 31,	
	2013	2014
Total RPMs	\$ 26.96	\$ 40.51
Traditional computer	45.17	54.42
Mobile and other connected devices	22.41	37.43

We track total revenue per thousand listener hours for our service because it is a key indicator of our ability to monetize our listener hours. We focus on total RPMs across all of our delivery platforms. Total RPMs compare advertising and subscription and other revenue generated in a given period to total listener hours in the period. We calculate total RPMs by dividing the total revenue generated by the number of thousands of listener hours.

The estimates used to derive disaggregated total RPMs for our traditional computer platform as well as our mobile and other connected devices platforms are similar to those used to derive ad RPMs. The changes in total RPMs were driven by the same factors mentioned above within the discussion of ad RPMs. In addition, the changes in total RPMs reflect a \$14.2 million increase in subscription revenue in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to “Deferred Revenue” below for further details regarding these in-app subscriptions.

Licensing Costs per Thousand Listener Hours (“LPMs”)

The table below sets forth our total LPMs for the three months ended March 31, 2013 and 2014.

	Three months ended March 31,	
	2013	2014
Total LPMs	\$ 20.10	\$ 22.57

We track licensing costs per thousand listener hours 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 increases which drive period over period changes in LPMs. As such, the margin on our business varies principally with variances in ad RPMs and subscription RPMs. Total LPMs in the three months ended March 31, 2014 increased compared to the respective prior year periods primarily due to scheduled rate increases.

Basis of Presentation and Results of Operations

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.

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	Three months ended March 31,	
	2013	2014
Revenue:		
Advertising	84%	72%
Subscription and other	16	28
Total revenue	100	100
Cost of revenue:		
Cost of revenue — Content acquisition costs	75	56
Cost of revenue — Other(1)	8	8
Total cost of revenue	83	64
Gross profit	17	36
Operating expenses:		
Product development(1)	6	6
Sales and marketing(1)	33	32
General and administrative(1)	12	14
Total operating expenses	51	52
Loss from operations	(34)	(16)
Other income (expense):		
Interest income	—	—
Interest expense	—	—
Other expense, net	—	—
Loss before provision for income taxes	(34)	(16)
Provision for income taxes	—	—
Net Loss	(34)%	(16)%

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	0.4%	0.5%
Product development	1.3	1.8
Sales and marketing	3.8	4.3
General and administrative	0.2	2.4

Revenue.

	Three months ended March 31,		\$ Change
	2013	2014	
	(in thousands)		
Advertising	\$ 96,714	\$ 140,634	\$ 43,920
Subscription and other	18,410	53,681	35,271
Total revenue	\$ 115,124	\$ 194,315	\$ 79,191

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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 and brokers pursuant to which we provide the ability to sell advertising inventory on our service directly to advertisers. We report revenue under these arrangements net of amounts due to agencies and brokers.

For the three months ended March 31, 2013 and 2014, advertising revenue accounted for 84% and 72% of our total revenue, respectively, and we expect that advertising will comprise a substantial majority of revenue for the foreseeable future. Advertising revenue increased \$43.9 million or approximately 45% in the three months ended March 31, 2014, primarily due to an approximate 47% increase in the average price per ad, particularly due to our focus on monetizing mobile inventory and due to fluctuations in the sales distribution mix amongst direct sales, third-party network sales and other channels, as we sold more ads on a direct sales basis in the three months ended March 31, 2014 as compared to 2013.

Subscription and other revenue.

Subscription and other revenue is generated primarily through the sale of 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 derived from direct sales to listeners is recognized on a straight-line basis over the duration of the subscription period.

For the three months ended March 31, 2013 and 2014, subscription and other revenue accounted for 16% and 28% of our total revenue, respectively. Subscription revenue increased \$35.3 million, or approximately 192%, primarily due to an increase in the number of subscribers and a \$14.2 million increase in subscription revenue in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to “Deferred Revenue” below for further details regarding these in-app subscriptions.

Deferred revenue.

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

In addition, subscription revenue derived from sales through certain mobile devices may be subject to refund or cancellation terms which may affect the timing or amount of the subscription revenue recognition. When refund rights exist, we recognize revenue when services have been provided and the rights lapse or when we have developed sufficient transaction history to estimate a return reserve. We were required to defer revenue for certain in application (“in-app”) mobile subscriptions that contained refund rights until the refund rights lapsed or we developed sufficient operating history to estimate a return reserve. As of December 31, 2013, we had deferred all revenue related to these in-app mobile subscriptions subject to refund rights totaling approximately \$14.2 million, as we did not have sufficient history to estimate a return reserve. Beginning in January 2014, we had sufficient historic transactional information which enabled us to estimate future returns. Accordingly, in January 2014, we began recording revenue related to these in-app mobile subscriptions net of estimated returns. This change resulted in a one-time increase in subscription revenue in the three months ended March 31, 2014 of approximately \$14.2 million, as the previously deferred revenue was recognized. As of March 31, 2014, the deferred revenue related to the return reserve was not significant.

Costs and Expenses

Cost of revenue consists of cost of revenue — content acquisition costs and cost of revenue — other. 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 March 31,			\$ Change
	2013	2014	(in thousands)	
Cost of revenue - content acquisition costs	\$ 85,823	\$ 108,275		\$ 22,452

Content acquisition costs as a percentage of advertising revenue by platform

	Three months ended March 31,	
	2013	2014
Traditional computer	45%	39%
Mobile and other connected devices	91%	67%

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 and are based on both percentage of revenue and listening metrics. 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 or a formula that involves a combination of per performance and revenue metrics. For royalty arrangements under negotiation, we accrue for estimated royalties based on the available facts and circumstances and adjust these estimates as more information becomes available. The results of any finalized negotiation may be materially different from our estimates.

We estimate our advertising-based content acquisition costs attributable to specific platforms by allocating costs from royalties payable based on a fee per track to the platform for which the track is served and by allocating costs from royalties based on a percentage of our revenue in accordance with the overall percentage of our revenue estimated to be attributable to such platforms. While we believe that comparing disaggregated content acquisition costs and revenues across our delivery platforms may provide directional insight for evaluating our efforts to monetize the rapid adoption of our service on mobile and other connected devices, we do not validate such disaggregated metrics to the level of financial statement reporting. We continue to refine our systems and methodologies used to categorize such metrics across our delivery platforms and the period-to-period comparisons of results are not necessarily indicative of results for future periods.

For the three months ended March 31, 2013 compared to 2014, content acquisition costs increased \$22.5 million primarily due to scheduled royalty rate increases and an increase in listener hours. Content acquisition costs as a percentage of total revenue decreased from 75% to 56%, primarily due to an increase in advertising sales and a \$14.2 million increase in subscription revenue in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our traditional computer platform decreased from 45% to 39%, primarily due to an increase in advertising sales on this platform as a result of an increase in the average price per ad, partially offset by scheduled rate increases. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our mobile and other connected devices platforms decreased from 91% to 67%, primarily due to an increase in advertising sales on those platforms and the effect of measures we have adopted to manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience, partially offset by scheduled rate increases.

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Cost of revenue—other.

	Three months ended March 31,		\$ Change
	2013	2014	
	(in thousands)		
Cost of revenue — other	\$ 9,776	\$ 14,979	\$ 5,203

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

For the three months ended March 31, 2013 compared to 2014, cost of revenue increased \$5.2 million primarily due to a \$2.0 million increase in other costs of ad sales related to events sold as part of advertising arrangements, a \$1.3 million increase in hosting and infrastructure costs driven by an increase in advertising revenue and a \$1.2 million increase in employee-related costs driven by an increase in headcount.

Gross profit

	Three months ended March 31,		\$ Change
	2013	2014	
	(in thousands)		
Total revenue	\$ 115,124	\$ 194,315	\$ 79,191
Total cost of revenue	95,599	123,254	27,655
Gross profit	\$ 19,525	\$ 71,061	\$ 51,536
Gross margin	17%	37%	

For the three months ended March 31, 2013 compared to 2014, gross profit increased by \$51.5 million primarily due to an increase in advertising revenue as a result of an increase in the average price per ad. Gross margin increased from 17% to 37% as the growth in advertising revenue outpaced the growth in content acquisition costs primarily due to an increase in advertising sales and the effect of measures we have adopted to manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience. The increase in gross margin was also due to an increase in subscription and other revenue driven by a \$14.2 million increase in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to “Deferred Revenue” above for further details regarding these in-app subscriptions.

Product development

	Three months ended March 31,		\$ Change
	2013	2014	
	(in thousands)		
Product development	\$ 6,667	\$ 11,831	\$ 5,164

Product development consists primarily of employee-related costs, including salaries and benefits related to employees in software engineering, music analysis and product management departments, facilities-related expenses, information technology and costs associated with supporting consumer connected-device manufacturers in implementing our service in their products. We incur product development expenses primarily for improvements to our website and the Pandora app, development of new advertising products and development and enhancement of our personalized station generating system. We have generally expensed product development as incurred. Certain website development and internal use software development costs may be 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 intend to continue making significant investments in developing new products and enhancing the functionality of our existing products.

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For the three months ended March 31, 2013 compared to 2014, product development expenses increased \$5.2 million primarily due to a \$4.6 million increase in employee-related costs driven by an increase in headcount.

Sales and marketing

	Three months ended March 31,		\$ Change
	2013	2014	
	(in thousands)		
Sales and marketing	\$ 38,045	\$ 61,864	\$ 23,819

Sales and marketing consists primarily of employee-related costs, including salaries, commissions and benefits related to employees in sales, sales support and marketing departments. In addition, sales and marketing expenses include transaction processing fees for subscription purchases on mobile platforms, external sales and marketing expenses such as third-party marketing, branding, advertising and public relations expenses, facilities-related expenses, infrastructure costs and credit card fees. We expect sales and marketing expenses to increase as we hire additional personnel to build out our sales and sales support teams, particularly as we build out our local market sales team.

For the three months ended March 31, 2013 compared to 2014, sales and marketing expenses increased \$23.8 million primarily due to a \$16.2 million increase in employee-related costs and a \$1.8 million increase in facilities and equipment expenses, both of which were driven by an increase in headcount, a \$4.1 million increase in transaction processing fees for subscription purchases on mobile platforms and a \$2.0 million increase in marketing expenses.

General and administrative

	Three months ended March 31,		\$ Change
	2013	2014	
	(in thousands)		
General and administrative	\$ 13,355	\$ 26,361	\$ 13,006

General and administrative consists primarily of employee-related costs, consisting of salaries and benefits 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, facilities-related expenses and infrastructure costs. 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.

For the three months ended March 31, 2013 compared to 2014, general and administrative expenses increased \$13.0 million primarily due to a \$7.2 million increase in employee-related costs driven by an increase in headcount and a \$4.1 million increase in professional services costs related to litigation and royalty-related matters.

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Income tax benefit (expense)

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

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

Off-Balance Sheet Arrangements

Our liquidity is not dependent on the use of off-balance sheet financing arrangements and as of March 31, 2014 we had no such arrangements. There has been no material change in our contractual obligations other than in the ordinary course of business since the eleven months ended December 31, 2013.

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.

Our results reflect the effects of seasonal trends in listener behavior. During the last three months of each calendar year, we experience higher advertising sales as a result of greater advertiser demand during the holiday season. We also experience lower advertising sales in the first three months of the calendar year due to reduced advertiser demand. In addition, we expect to experience increased usage during the last three months of each calendar year during the holiday season, and in the first three months of each calendar year 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. We believe that our business may become more seasonal in the future and that such seasonal variations in listener behavior may result in fluctuations in our financial results.

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

Liquidity and Capital Resources

As of March 31, 2014, we had cash, cash equivalents and investments totaling \$445.9 million, which 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 months ending March 31, 2014 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.

[Table of Contents](#)*Our Indebtedness*

We are party to a \$60.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. Refer to Note 8 “Debt Instruments” in the Notes to Condensed Consolidated Financial Statements for further details regarding our credit facility.

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 three months ended March 31, 2013 and 2014.

	Three months ended March 31,	
	2013	2014
	(in thousands) (unaudited)	
Net cash used in operating activities	\$ (12,877)	\$ (2,235)
Net cash provided by (used in) investing activities	1,147	(93,353)
Net cash provided by financing activities	4,033	10,614

Operating activities

In the three months ended March 31, 2014, net cash used in operating activities was \$2.2 million, including our net loss of \$28.9 million, which was partially offset by non-cash charges of \$21.5 million, primarily related to \$17.4 million in stock-based compensation charges. Net cash used in operating activities also included a \$14.5 million decrease in deferred revenue from the prior period primarily due to the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions, offset by cash from collections of accounts receivables.

Investing activities

In the three months ended March 31, 2014, net cash used in investing activities was \$93.4 million, primarily due to \$115.6 million for purchases of investments and \$11.8 million for capital expenditures for leasehold improvements and server equipment, partially offset by \$34.0 million in maturities of investments.

Financing activities

In the three months ended March 31, 2014, net cash provided by financing activities was \$10.6 million, primarily consisting of proceeds from the issuance of common stock.

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 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.

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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.

Other than those discussed below, there have been no material changes to our critical accounting policies and estimates as compared to those described in our Transition Report on Form 10-K for the eleven months ended December 31, 2013 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates.”

Deferred Revenue

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

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 Transition Report on Form 10-K for the eleven months ended December 31, 2013. For further discussion of quantitative and qualitative disclosures about market risk, reference is made to our Transition Report on Form 10-K.

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 March 31, 2014.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the three months ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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 Transition Report on Form 10-K for the eleven months ended December 31, 2013 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 Transition Report on Form 10-K for the eleven months ended December 31, 2013, other than as set forth below. The risk factors below, all of which originally appear in our Transition Report on Form 10-K, have been updated to reflect additional information regarding third party measurement, royalties and litigation, among other things.

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

Selling ads, locally and nationally, requires that we demonstrate to advertisers that our service has substantial reach and usage. Third-party measurements may not reflect our true listening audience and their underlying methodologies are subject to change at any time. In addition, the methodologies we apply to measure the key metrics that we use to monitor and manage our business may differ from the methodologies used by third-party measurement service providers. For example, 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. By contrast, certain third-party measurement service providers may calculate and report the number of listener hours using a client-based approach, which measures time elapsed during listening sessions. Measurement technologies for mobile and consumer electronic devices may be even less reliable in quantifying the reach, usage and location of our service, and it is not clear whether such technologies will integrate with our systems or uniformly and comprehensively reflect the reach, usage and location of our service. While we have been working with third-party measurement service providers and earning Media Ratings Council accreditation for these measurements, some providers have not yet developed uniform measurement systems that comprehensively measure the reach, usage and location of our service. In order to demonstrate to potential advertisers the benefits of our service, we must supplement third-party measurement data with our internal research, which may be perceived as less valuable than third-party numbers. If such third-party measurement providers report lower metrics than we do, or if there is wide variance among reported metrics, our ability to convince advertisers of the benefits of our service could be adversely affected.

The lack of accurate cross-platform measurements for internet radio and broadcast radio may adversely affect our ability to grow advertising revenue.

Pandora has invested substantial resources to create accurate cross-platform measurements for internet radio and broadcast radio in the major automated media-buying platforms, creating a one-stop shop that enables media buyers to compare internet radio audience reach with terrestrial radio audience reach using traditional broadcast radio metrics. To achieve this result, we currently rely on third parties such as Triton to quantify the reach and usage of our service and on media buying companies to provide Internet radio metrics side-by-side with terrestrial radio metrics in media-buying platforms.

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We have also partnered with media buying companies that show internet radio measurements alongside terrestrial metrics in the media buying systems that media buyers use to purchase advertising. Media buying companies receive measurement metrics from third parties, such as Triton for internet radio and Nielsen for more traditional media like terrestrial radio and television. Media buying companies may choose not to show, or may be prohibited by third-party measurement services that measure terrestrial radio and other traditional media from showing, internet radio metrics alongside traditional terrestrial metrics. Our ability to realize our long-term potential will be significantly affected by our success in these advertising initiatives, and there is no assurance we will achieve substantial penetration of these advertising markets.

We depend upon third-party licenses for the right to publicly perform musical works and a change to these licenses could materially increase our content acquisition costs.

Our content costs, in part, are comprised of the royalties we pay for the public performance of musical works embodied in the sound recordings that we stream. As described in “Business—Content, Copyrights and Royalties—Musical Works” in our Transition Report on Form 10-K for the eleven months ended December 31, 2013, to secure the rights to publicly perform musical works embodied in sound recordings over the internet, we obtain licenses from or for the benefit of copyright owners and pay royalties to copyright owners or their agents. Copyright owners of musical works are vigilant in protecting their rights and currently are seeking substantial increases in the rates applicable to the public performance of such works. There is no guarantee that the licenses available to us now will continue to be available in the future or that such licenses will be available at the royalty rates associated with the current licenses. If we are unable to secure and maintain rights to publicly perform musical works or if we cannot do so on terms that are acceptable to us, our ability to perform music content to our listeners, and consequently our ability to attract and retain both listeners and advertisers, will be adversely impacted.

Copyright owners of musical works, typically, songwriters and music publishers, have traditionally relied on intermediaries known as performing rights organizations to negotiate so-called “blanket” licenses with copyright users, collect royalties under such licenses, and distribute them to copyright owners. We have obtained public performance licenses from, and pay license fees to, the three major performing rights organizations in the United States: the American Society of Composers, Authors and Publishers (“ASCAP”), Broadcast Music, Inc. (“BMI”) and SESAC, Inc. (“SESAC”).

We currently operate under an agreement with SESAC, which automatically renews yearly, but is subject to termination by either party in accordance with its terms at the end of each yearly term. The SESAC rate is subject to small annual increases. There is no guarantee that either the license or the associated royalty rate available to us now with respect to SESAC will be available to us in the future.

We currently operate under interim licenses with each of ASCAP and BMI. ASCAP and BMI each are governed by a consent decree with the United States Department of Justice. The rates we pay ASCAP and BMI can be established by either negotiation or through a rate court proceeding conducted by the United States District Court for the Southern District of New York. We elected to terminate our prior agreements with ASCAP as of December 31, 2010 and with BMI as of December 31, 2012 because, among other things, we believed that the royalty rates sought by ASCAP and BMI were in excess of rates paid by our largest radio competitors, broadcast radio stations and satellite radio. Notwithstanding our termination of these agreements, the musical works administered by each of ASCAP and BMI continued to be licensed to us pursuant to the provisions of their respective consent decrees. In November 2012, we filed a petition requesting that the ASCAP rate court determine reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. In June 2013, BMI filed a petition requesting that the BMI rate court determine reasonable license fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2017. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014 and the court issued its opinion in March 2014. A trial date has not been set for the BMI rate court proceeding. Each of these proceedings has been, and is expected to continue to be, protracted, expensive and uncertain in outcome. It is likely that trial level outcomes will be appealed and the final resolution may not be known for years. In the event that these matters are resolved adversely to us, our content acquisition costs could increase significantly, which would adversely affect our operating results. Notwithstanding the ASCAP court decision, there is no guarantee that final rates established by mutual agreement or by a rate court determination would establish royalty rates more favorable to us than those we previously paid pursuant to our terminated agreements with ASCAP and/or BMI or those that we pay pursuant to our interim arrangements with ASCAP and/or BMI. For the eleven months ended December 31, 2013, we incurred content acquisition costs for the public performance of musical works representing approximately 4% of our total revenue for that period.

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We do not currently pay so-called “mechanical royalties” to music publishers for the reproduction and distribution of musical works embodied in server copies or transitory copies used to make streams audible to our listeners. Although not currently a matter of dispute, if music publishers were to retreat from the publicly stated position of their trade association that non-interactive streaming does not require the payment of a mechanical royalties, and a final judgment were entered by a court requiring that payment, our royalty obligations could increase significantly, which would increase our operating expenses and harm our business and financial interests. While we would vigorously challenge such mechanical royalties as not required by law, our challenge may be unsuccessful and would in any case involve commitment of substantial time and resources. In addition, we stream spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization in the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization or individual rights owners, although royalties are paid to SoundExchange for the public performance of the sound recordings in which such literary works are embodied. There can be no assurance that this industry custom will not change or that we will not otherwise become subject to additional licensing costs for spoken word comedy content imposed by performing rights organizations or individual copyright owners in the future or be subject to damages for copyright infringement.

Assertions by third parties of violations under state law with respect to the public performance and reproduction of pre-1972 sound recordings could result in significant costs and substantially harm our business and operating results.

As described in “Business—Content, Copyrights and Royalties—Sound Recordings” in our Transition Report on Form 10-K for the eleven months ended December 31, 2013, sound recordings made on or after February 15, 1972 fall within the scope of federal copyright protection. Subject to our ongoing compliance with numerous federal statutory conditions and regulatory requirements for a noninteractive service, we are permitted to operate our radio service under a statutory license that allows the streaming in the U.S. of any such sound recording lawfully released to the public and permits us to make reproductions of such sound recordings on computer servers pursuant to a separate statutory license designed to facilitate the making of such transmissions.

By contrast, protection of sound recordings created prior to February 15, 1972 (“pre-1972 sound recordings”) remains governed by a patchwork of state statutory and common laws. Copyright owners of pre-1972 sound recordings have commenced litigation against us, alleging violations of New York state statutory and common laws with respect to the unauthorized reproduction and public performance of pre-1972 sound recordings, seeking, among other things, restitution, disgorgement of profits, and punitive damages as well as injunctive relief prohibiting further violation of those copyright owners’ alleged exclusive rights. Similar litigation has been brought previously against Sirius XM Radio Inc. for similar claims. If we are found liable for the violation of the exclusive rights of any pre-1972 sound recording copyright owners, then we could be subject to liability, the amount of which could be significant. If we are required to obtain licenses from individual sound recording copyright owners for the reproduction and public performance of pre-1972 sound recordings, then the time, effort and cost of securing such licenses directly from all owners of sound recording used on our service could be significant and could harm our business and operating results. If we are required to obtain licenses for pre-1972 sound recordings to avoid liability and are unable to secure such licenses, then we may have to remove pre-1972 sound recordings from our service, which could harm our ability to attract and retain users.

Our royalty payments are subject to audits and our royalty calculation methods involve significant estimates.

The royalties that we pay to SoundExchange for the streaming of sound recordings are calculated using a per performance rate. While we believe that the mechanisms we use to track performances are sufficient to ensure that we are accurately reporting and paying royalties, our ability to do so depends in part on our ability to maintain these mechanisms as new devices are introduced and technologies evolve. Any understatement or overstatement of performances could result in our paying lower or higher royalties to SoundExchange than we actually owed, which could in turn affect our financial condition and results of operations. SoundExchange has the right to audit our royalty payments and in December 2013 informed us that it intends to audit our payments for the years 2010, 2011, and 2012. In addition, performing rights organizations and musical work copyright owners with whom we have entered into direct licenses have or may have the right to audit our royalty payments, and any such audit could result in disputes over whether we have paid the proper royalties. If such a dispute were to occur, we could be required to pay additional royalties and audit fees. The amounts involved could be material.

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Rate court proceedings, the attempted and/or purported withdrawal of certain music publishers or the rights to certain of their works for certain purposes from ASCAP and BMI, and our recent entry into a local marketing agreement to program KXMZ-FM have highlighted uncertainties for the royalty rates that we pay for the public performance of musical works. For example, we could be liable for both increased royalty rates going forward and a potential true-up of royalty payments in excess of any interim royalties paid for the period following December 31, 2010 with respect to ASCAP if ASCAP successfully appeals the rate court's March 2014 ruling and/or for the period following December 31, 2012 with respect to BMI. We record a liability for public performance royalties based on our best estimate of the amount owed to each organization based on historical rates, third-party evidence and legal developments. For each quarterly period, we evaluate our estimates to assess the adequacy of recorded liabilities. If actual royalty rates differ from estimates, revisions to the estimated royalty liabilities may be required, which could materially affect our results of operations. Any royalty audit could result in disputes over whether we have paid the proper royalties.

Item 6. Exhibits

Exhibit No.	Exhibit Description	Incorporated by Reference					Filed Herewith
		Form	File No.	Exhibit	Filing Date	Filed By	
10.19C†	Calendar 2014 Corporate Incentive Plan						X
10.26†	Joseph Kennedy Advisory Agreement, dated January 31, 2014						X
31.01	Certification of the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act						X
31.02	Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act						X
32.01	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act						X
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Balance Sheets as of March 31, 2014 and December 31, 2013, (ii) Condensed Statements of Operations for the Three months ended March 31, 2014 and 2013, (iii) Condensed Statements of Comprehensive Loss for the Three months Ended March 31, 2014 and 2013, (iv) Condensed Statements of Cash Flows for the Three months ended March 31, 2014 and 2013 and (v) Notes to Condensed Financial Statements						X

† Indicates management contract or compensatory plan.

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: April 29, 2014

By: /s/ Michael S. Herring

Michael S. Herring
Executive Vice President and Chief
Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting
Officer)

Pandora Media Corporate Incentive Plan for Fiscal Year Ending December 31, 2014

The Pandora Media, Inc. (“**Pandora**”) Corporate Incentive Plan for the fiscal year ending December 31, 2014 (the “**Plan**”) is designed to reward eligible employees for their efforts toward the accomplishment of Pandora’s goals during the Plan Year. For purposes of the Plan, “**Plan Year**” means Pandora’s fiscal year starting January 1, 2014 through and including December 31, 2014 (“**Calendar Year 2014**”).

Eligibility

Eligibility under the Plan does not represent a commitment or guarantee that you will receive any payment under the Plan. If, for any reason, you are not an active employee of Pandora (or one of its eligible subsidiaries as determined by the Compensation Committee) in good standing on the last day of Calendar Year 2014, you will not be eligible to receive a bonus under the Plan. Furthermore, the decision to pay any bonus under the Plan remains in the full discretion of the Compensation Committee of Pandora’s Board of Directors.

Selected employees at the manager or equivalent level and all employees at the director level and above are eligible (an “**Eligible Position**”). To receive any payment under the Plan, an eligible employee must remain an employee in good standing on the last day of the Plan Year (December 31, 2014).

New Hires and Promotions into Eligible Positions. Eligible employees hired or promoted into an Eligible Position after the beginning of the Plan Year will have any bonus prorated to reflect the length of time employed in an Eligible Position during the Plan Year. However, employees hired or promoted into an Eligible Position after November 1, 2014 will not be eligible for the Plan.

Changes Between Eligible Positions. Eligible employees who move from one Eligible Position to another Eligible Position with a different Target Bonus (as defined below) will have any bonus prorated to reflect the different Target Bonus (as defined below) amounts based on the length of time employed in each Eligible Position.

Target Bonus Opportunity

Each Eligible Position is assigned a target bonus amount (“**Target Bonus**”), generally expressed as a percentage of earned salary for the applicable period. Your manager will discuss your Target Bonus with you. There is no guarantee that you will receive your Target Bonus, and you may receive a lower or higher amount or no bonus.

Plan Administration

The Compensation Committee will have sole discretion to determine the aggregate pool (the “**Bonus Pool**”) under the Plan, as described below, depending solely upon its assessment of Pandora’s overall performance measured against objectives that the Compensation Committee and management will discuss from time to time. In exercising its discretion, the Compensation

Committee will consider any extraordinary activities during the year, including mergers, acquisitions, new market expansion and other strategic initiatives. Pandora and the Compensation Committee may amend, suspend or terminate the Plan at any time and in any manner. **All payments under the Plan are discretionary. Regardless of whether any specific performance metrics are set for any Plan Year, the decisions as to whether, and how much, to fund the Bonus Pool remain in the full discretion of the Compensation Committee, and Pandora's financial results for any Plan Year shall not be deemed to give any eligible employee a right to any payment under the Plan.**

The Incentive Committee of Pandora (the "**Incentive Committee**") is responsible for administering the Plan with respect to employees who are not executive officers ("**Non-Executive Employees**"), subject to the direction of the Compensation Committee. Members of the Incentive Committee shall be the CEO and/or any officers or managers appointed by the CEO to the Incentive Committee. The Incentive Committee will, in its discretion, determine a Non-Executive Employee's eligibility under the Plan, including whether part-time employees are eligible and whether Pandora will pay prorated bonuses for Non-Executive Employees who retire (and, if so, the retirement criteria) or die during the Plan Year. All determinations, interpretations, rules and decisions of the Compensation Committee and/or the Incentive Committee shall be conclusive and binding upon all persons claiming to have any interest or right under the Plan.

Bonus Payments

In order to receive any payment under the Plan, an eligible employee must remain an active employee on the last day of the fiscal year (December 31, 2014). If, before such date(s), your employment is terminated (whether by you or by Pandora, regardless of the reason), you will not be eligible to receive a bonus under the Plan.

The Compensation Committee will determine the Bonus Pool and the individual payments to each executive officer of Pandora.

With respect to the Non-Executive Employees, the CEO of Pandora shall have the discretion to determine the portion of the remaining Bonus Pool that will be awarded to any individual or to any department or business unit and to delegate responsibility for determining individual payments to your manager.

As a result, the actual payment to you of a bonus, if any, under the Plan is subject to the discretion of the Compensation Committee, the CEO and your manager.

Operating Guidelines

No eligible employee may rely on any verbal or other information outside of this Plan. Pandora reserves the right to amend, discontinue or make significant changes to the Plan at any time and for any reason, with or without notice. Eligibility for a bonus under this Plan does not guarantee eligibility for any future payments or bonus programs.

At Will Employment

Nothing in the Plan shall confer upon any employee or other Plan participant any right to continued employment or service with Pandora for any specific duration or otherwise restrict in any way the rights of Pandora or any employee to terminate an eligible employee's employment at any time, for any reason, with or without cause.

Tax Withholding

Pandora shall withhold from the payments under the Plan all federal, state and local income or other taxes required to be withheld therefrom and any other required payroll deductions, and as a condition precedent to payment under the Plan, all recipients shall make arrangements satisfactory to Pandora for the payment of any personal income or other taxes. All payments hereunder are intended to qualify for the short-term deferral exception from Section 409A of the Internal Revenue Code and, if required to qualify for such exception, shall be made no later than 2 and 1/2 months following the end of the taxable year in which an individual becomes legally entitled to, or vested in, a payment hereunder.

Miscellaneous

This Plan is unfunded. In no event may a participant sell, transfer, anticipate, assign or otherwise dispose of any right or interest under the Plan or relating hereto. At no time will any such right or interest under the Plan be subject to the claims of any participant's creditors or liable to attachment, execution or other legal process.



January 31, 2014

Mr. Joseph Kennedy

Dear Joe:

The purpose of this letter is to confirm the agreement that Pandora Media, Inc. ("Pandora") engage you as a consultant who will help Pandora with certain strategy planning as further described in this letter agreement.

1. Scope of Services. The services that you will perform are described on Exhibit A (the "Services").
2. Term. You agree to begin providing services to Pandora on February 1, 2014 and shall continue through December 31, 2014 or until earlier terminated by either party with thirty days' prior notice. Termination must be in writing to be effective, but may be delivered by email to you at ***** or to Pandora at ***** or *****. For the avoidance of doubt, this means that your last day of employment on January 31, 2014 will be the date your Continuous Service Status (as defined under each of the 2004 Stock Plan and the 2011 Equity Incentive Plan) ends.

Payment. In consideration of the foregoing services, Pandora shall pay you a monthly fee of \$1,000, subject to the terms of this letter agreement.

- a. Pandora shall reimburse you for actual, out-of-pocket expenses that are associated with an activity (e.g., travel, research) that the chief executive officer or general counsel approve, which expenses are documented by receipts.
 - b. You will issue invoices for fees and reimbursable expenses within thirty days of the end of each month. Pandora will pay all undisputed invoices within 30 days of receipt of invoice. You are solely responsible for any taxes associated with your compensation under this letter agreement, including any applicable reporting, withholding, and payment requirements.
3. Confidentiality. During the term of this letter agreement, you may receive Confidential Information (defined below). You must not use or disclose such Confidential Information except as set forth in this letter agreement and must promptly notify Pandora of any actual or suspected misuse or unauthorized disclosure of Confidential Information, or if you receive a subpoena or other order of a court or government agency that requires the disclosure of the Confidential

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Information. "Confidential Information" means any Pandora non-public or proprietary information and materials. All information which you acquire or become acquainted with during the period of this letter agreement, whether developed by you or by others, which you have a reasonable basis to believe to be Confidential Information is presumed to be Confidential Information. If you breach the confidentiality provisions of this paragraph, Pandora will be irreparably injured. As such, you agree that Pandora is entitled, in addition to any other remedies available at law or in equity, to extraordinary relief in court, including, without limitation, specific performance, temporary restraining orders, preliminary injunctions and permanent injunctions, to prevent the breach or threatened breach of this paragraph.

4. Miscellaneous. This letter agreement will be construed and interpreted according to the laws of the State of California without regard to conflict of laws principles. Any disputes arising from or related to this letter agreement will be brought exclusively in the state or Federal courts located in Alameda County, California, and the parties hereby consent to the personal jurisdiction of these courts for such purposes.

Please indicate your acceptance of the terms set forth in this letter agreement by signing a copy of this letter in the space indicated below. We look forward to working with you.

Sincerely,

/s/ Delida Costin

Delida Costin
General Counsel

AGREED AND ACCEPTED:

/s/ Joseph J Kennedy

Print Name: /s/ Joseph J Kennedy

Date: 1/31/2014

Exhibit A

Provide strategic advice to assist Pandora in rate-setting proceedings and negotiations with publishers and labels for the public performance of sound recordings and musical compositions

**Certification of Principal Executive Officer
Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

I, Brian McAndrews, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pandora Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

April 29, 2014

/s/ Brian McAndrews

Name: Brian McAndrews

Title: *Chief Executive Officer, President and Chairman of the Board
(Principal Executive Officer)*

**Certification of Principal Financial Officer
Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

I, Michael S. Herring, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pandora Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

April 29, 2014

/s/ Michael S. Herring

Name: Michael S. Herring

Title: *Executive Vice President and Chief Financial Officer (Principal Financial Officer)*

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF SARBANES-OXLEY ACT OF 2002**

The certification set forth below is being submitted in connection with this Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 (the "Report") for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Each of the undersigned certifies that, to his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Pandora Media, Inc.

April 29, 2014

/s/ Brian McAndrews

Name: Brian McAndrews

Title: *Chief Executive Officer, President and Chairman of the Board
(Principal Executive Officer)*

/s/ Michael S. Herring

Name: Michael S. Herring

Title: *Executive Vice President and Chief Financial Officer (Principal
Financial Officer)*

This certification accompanying the Report is not deemed filed with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities such Section, and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before, on or after the date of the Report), irrespective of any general incorporation language contained in such filing.

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

FORM 10-Q

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 001-35198

Pandora Media, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

**2101 Webster Street, Suite 1650
Oakland, CA**
(Address of principal executive offices)

94-3352630
(I.R.S. Employer
Identification No.)

94612
(Zip Code)

(510) 451-4100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ 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 ☐
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

The number of shares of registrant's common stock outstanding as of July 24, 2014 was: 206,488,061.

Pandora Media, Inc.
FORM 10-Q Quarterly Report
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Pandora Media, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except share and per share amounts)
(Unaudited)

	As of December 31, 2013	As of June 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 245,755	\$ 157,848
Short-term investments	98,662	166,429
Accounts receivable, net of allowance of \$1,272 at December 31, 2013 and \$947 at June 30, 2014	164,023	177,218
Prepaid expenses and other current assets	10,343	10,512
Total current assets	518,783	512,007
Long-term investments	105,686	113,647
Property and equipment, net	35,151	40,147
Other long-term assets	13,715	13,701
Total assets	\$ 673,335	\$ 679,502
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 14,413	\$ 11,395
Accrued liabilities	14,881	13,147
Accrued royalties	66,110	72,259
Deferred revenue	42,650	22,763

Accrued compensation	17,952	31,102
Total current liabilities	156,006	150,666
Other long-term liabilities	9,098	10,374
Total liabilities	165,104	161,040
Stockholders' equity:		
Common stock: 195,395,940 shares issued and outstanding at December 31, 2013 and 206,291,969 at June 30, 2014	20	21
Additional paid-in capital	675,103	725,776
Accumulated deficit	(166,591)	(207,250)
Accumulated other comprehensive loss	(301)	(85)
Total stockholders' equity	508,231	518,462
Total liabilities and stockholders' equity	<u>\$ 673,335</u>	<u>\$ 679,502</u>

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

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

	Three months ended June 30,		Six months ended June 30,	
	2013 (recast)	2014	2013 (recast)	2014
Revenue				
Advertising	\$ 127,555	\$ 177,324	\$ 224,269	\$ 317,958
Subscription and other	25,549	41,570	43,959	95,251
Total revenue	153,104	218,894	268,228	413,209
Cost of revenue				
Cost of revenue - Content acquisition costs	79,828	111,461	165,651	219,736
Cost of revenue - Other	10,847	13,989	20,623	28,968
Total cost of revenue	90,675	125,450	186,274	248,704
Gross profit	62,429	93,444	81,954	164,505
Operating expenses				
Product development	7,895	13,076	14,562	24,907
Sales and marketing	44,371	66,232	82,416	128,096
General and administrative	16,931	25,865	30,286	52,226
Total operating expenses	69,197	105,173	127,264	205,229
Loss from operations	(6,768)	(11,729)	(45,310)	(40,724)
Other income (expense), net	(122)	100	(249)	192
Loss before provision for income taxes	(6,890)	(11,629)	(45,559)	(40,532)
Income tax expense	(12)	(99)	(29)	(127)
Net loss	<u>\$ (6,902)</u>	<u>\$ (11,728)</u>	<u>\$ (45,588)</u>	<u>\$ (40,659)</u>
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	174,789	205,706	173,766	202,798
Net loss per share, basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>	<u>\$ (0.26)</u>	<u>\$ (0.20)</u>

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

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Pandora Media, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2013 (recast)	2014	2013 (recast)	2014
Net loss	\$ (6,902)	\$ (11,728)	\$ (45,588)	\$ (40,659)
Change in foreign currency translation adjustment	(53)	(2)	(57)	16
Change in net unrealized losses on marketable securities	1	85	4	200
Other comprehensive income (loss)	(52)	83	(53)	216
Total comprehensive loss	<u>\$ (6,954)</u>	<u>\$ (11,645)</u>	<u>\$ (45,641)</u>	<u>\$ (40,443)</u>

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Pandora Media, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six months ended June 30,	
	2013 (recast)	2014
Operating activities		
Net loss	\$ (45,588)	\$ (40,659)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	4,535	7,109
Stock-based compensation	16,662	38,005
Amortization of premium on investments	80	1,380
Amortization of debt issuance costs	132	99
Changes in assets and liabilities		
Accounts receivable	(14,060)	(13,195)
Prepaid expenses and other assets	(10,602)	(3,366)
Accounts payable and accrued liabilities	14,038	1,095
Accrued royalties	3,750	6,145
Accrued compensation	421	10,748
Deferred revenue	12,853	(19,887)
Reimbursement of cost of leasehold improvements	276	3,161
Net cash used in operating activities	(17,503)	(9,365)
Investing activities		
Purchases of property and equipment	(11,011)	(16,311)
Changes in restricted cash	(3,200)	—
Purchases of investments	(23,434)	(194,122)
Proceeds from maturities of investments	29,690	116,831
Payments related to acquisition	(400)	—
Net cash used in investing activities	(8,355)	(93,602)
Financing activities		
Proceeds from employee stock purchase plan	—	2,482
Proceeds from issuance of common stock	6,086	12,562
Net cash provided by financing activities	6,086	15,044
Effect of exchange rate changes on cash and cash equivalents	(54)	16
Net decrease in cash and cash equivalents	(19,826)	(87,907)
Cash and cash equivalents at beginning of period	59,939	245,755
Cash and cash equivalents at end of period	<u>\$ 40,113</u>	<u>\$ 157,848</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	\$ 164	\$ 246
Purchases of property and equipment recorded in accounts payable and accrued liabilities	\$ 1,783	\$ 3,337

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

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Pandora Media, Inc.
Notes to Condensed Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Pandora Media, Inc. provides an internet radio service offering a personalized experience for each listener wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. We also offer a paid subscription service which we call Pandora One. We were incorporated as a California corporation in January 2000 and reincorporated as a Delaware corporation in December 2010.

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

Basis of Presentation

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) and include the accounts of Pandora and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of our management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of our financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in our Transition Report on Form 10-K for the eleven months ended December 31, 2013.

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

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. Our statements of operations now include the presentation of gross profit, which is calculated as total revenue less cost of revenue. In addition, we have reclassified certain software license fees, facilities-related expenses and depreciation expenses among the general and administrative, cost of revenue — other, sales and marketing and product development lines in our condensed consolidated statements of operations. Furthermore, we have reclassified certain compensation-related amounts from the accrued liabilities line item to the accrued compensation line item of our condensed consolidated balance sheets and our condensed consolidated statements of cash flows.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Estimates are used for determining accrued royalties, selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, stock-based compensation, income taxes and the subscription return reserve. To the extent there are material differences between these estimates, judgments, or assumptions and actual results, our financial statements could be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. GAAP and does not require management’s judgment in its application. There are also areas in which management’s judgment in selecting among available alternatives would not produce a materially different result.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

2. Summary of Significant Accounting Policies

Other than discussed below, there have been no material changes to our significant accounting policies as compared to those described in our Transition Report on Form 10-K for the eleven months ended December 31, 2013.

Stock-Based Compensation — Employee Stock Purchase Plan

In December 2013, our board of directors approved the Employee Stock Purchase Plan (“ESPP”), which was approved by our stockholders at the annual meeting in June 2014. We estimate the fair value of shares to be issued under the ESPP on the first day of the offering period using the Black-Scholes valuation model. The determination of the fair value is affected by our stock price on the first date of the offering period, as well as other assumptions including the risk-free interest rate, the estimated volatility of our stock price over the term of the offering period, the expected term of the offering period and the expected dividend rate. Stock-based compensation expense related to the ESPP is recognized on a straight-line basis over the offering period, net of estimated forfeitures.

Deferred Revenue

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

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

We were required to defer revenue for certain in application (“in-app”) mobile subscriptions that contained refund rights until the refund rights lapsed or until we developed sufficient operating history to estimate a return reserve. As of December 31, 2013, we had deferred all revenue related to these in-app mobile subscriptions subject to refund rights totaling approximately \$14.2 million, as we did not have sufficient history to estimate a return reserve. Beginning in January 2014, we had sufficient historic transactional information which enabled us to estimate future returns. Accordingly, in January 2014, we began recording revenue related to these in-app mobile subscriptions net of estimated returns. This change resulted in a one-time increase in subscription revenue in the three months ended March 31, 2014 of approximately \$14.2 million, as the previously deferred revenue was recognized. As of June 30, 2014, the deferred revenue related to the return reserve was not significant.

Concentration of Credit Risk

For the three and six months ended June 30, 2013 and 2014, we had no customers that accounted for more than 10% of our total revenue. As of December 31, 2013 and June 30, 2014, we had no customers that accounted for more than 10% of our total accounts receivable.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 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 is effective for public entities with annual and interim reporting periods beginning after December 15, 2016. 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.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

3. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments consisted of the following:

	As of December 31, 2013	As of June 30, 2014
	(in thousands)	
Cash and cash equivalents:		
Cash	\$ 89,176	\$ 51,648
Money market funds	98,437	91,195
Commercial paper	54,247	7,749
Corporate debt securities	3,895	7,256
Total cash and cash equivalents	\$ 245,755	\$ 157,848
Short-term investments:		
Commercial paper	\$ 47,526	\$ 70,935
Corporate debt securities	50,436	95,494
U.S. government and government agency debt securities	700	—
Total short-term investments	\$ 98,662	\$ 166,429
Long-term investments:		
Corporate debt securities	\$ 100,690	\$ 103,793
U.S. government and government agency debt securities	4,996	9,854
Total long-term investments	\$ 105,686	\$ 113,647
Cash, cash equivalents and investments	\$ 450,103	\$ 437,924

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

The following tables summarize our available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category as of December 31, 2013 and June 30, 2014.

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

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	As of June 30, 2014			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Money market funds	\$ 91,195	\$ —	\$ —	\$ 91,195

Commercial paper	78,684	—	—	78,684
Corporate debt securities	206,587	82	(126)	206,543
U.S. government and government agency debt securities	9,866	—	(12)	9,854
Total cash equivalents and marketable securities	<u>\$ 386,332</u>	<u>\$ 82</u>	<u>\$ (138)</u>	<u>\$ 386,276</u>

The following table presents available-for-sale investments by contractual maturity date as of December 31, 2013 and June 30, 2014.

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

	As of June 30, 2014	
	Adjusted Cost	Fair Value
	(in thousands)	
Due in one year or less	\$ 271,638	\$ 271,600
Due after one year through three years	114,694	114,676
Total	<u>\$ 386,332</u>	<u>\$ 386,276</u>

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, 2014 were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of June 30, 2014, we owned 98 securities that were in an unrealized loss position. We do not intend nor expect to need to sell these securities before recovering the associated unrealized losses. We expect to recover the full carrying value of these securities. As a result, no portion of the unrealized losses at June 30, 2014 is deemed to be other-than-temporary and the unrealized losses are not deemed to be credit losses. No available-for-sale securities have been in an unrealized loss position for twelve months or more. When evaluating the investments for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and any changes thereto, and our intent to sell, or whether it is more likely than not we will be required to sell, the investment before recovery of the investment’s amortized cost basis. During the three and six months ended June 30, 2014, we did not recognize any impairment charges.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

4. Fair Value

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

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

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

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

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

The fair value of these financial assets and liabilities was determined using the following inputs at December 31, 2013 and June 30, 2014:

	As of December 31, 2013		
	Fair Value Measurement Using		
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
	(in thousands)		
Assets:			
Money market funds	\$ 98,437	\$ —	\$ 98,437
Commercial paper	—	101,773	101,773

Corporate debt securities	—	155,021	155,021
U.S. government and government agency debt securities	—	5,696	5,696
Total assets measured at fair value	<u>\$ 98,437</u>	<u>\$ 262,490</u>	<u>\$ 360,927</u>

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	As of June 30, 2014		
	Fair Value Measurement Using		
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Total
	(in thousands)		
Assets:			
Money market funds	\$ 91,195	\$ —	\$ 91,195
Commercial paper	—	78,684	78,684
Corporate debt securities	—	206,543	206,543
U.S. government and government agency debt securities	—	9,854	9,854
Total assets measured at fair value	<u>\$ 91,195</u>	<u>\$ 295,081</u>	<u>\$ 386,276</u>

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, 2013 and June 30, 2014, we held no Level 3 assets or liabilities.

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Pandora Media, Inc.
Notes to Condensed Consolidated Financial Statements - Continued
5. Commitments and Contingencies
Legal Proceedings

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

In June 2011, a putative class action lawsuit was filed against Pandora in the United States District Court for the Northern District of California alleging that we unlawfully accessed and transmitted personally identifiable information of the plaintiffs in connection with their use of our Android mobile application. In addition to civil liability, the amended complaint includes allegations of violations of statutes under which criminal penalties could be imposed if we were found liable. Our motion to dismiss the first amended complaint was granted on March 26, 2013. The plaintiff filed a second amended complaint in May 2013, which contains allegations similar to those contained in the previous complaint. On March 10, 2014, our motion to dismiss was granted in part and denied in part.

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

On September 10, 2012, B.E. Technology, LLC filed suit against Pandora in the United States District Court for the Western District of Tennessee alleging that we infringe a B.E. Technology patent and seeking injunctive relief and monetary damages. We filed our answer on December 31, 2012. Defendants in other suits in which B.E. Technology is plaintiff have filed inter partes review petitions before the U.S. Patent and Trademark Office challenging the validity of the patent Pandora is alleged to have infringed. The trial court granted Pandora's motion to stay this litigation until the inter partes review has been concluded.

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

We are also subject to legal proceedings involving musical work royalty rates. On November 5, 2012, we filed a petition in the rate court established by the consent decree between the American Society of Composers, Authors and Publishers ("ASCAP") and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. On June 11, 2013 we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights

ASCAP could license on behalf of such publishers subsequent to the date of our request for a license from ASCAP were not valid as to our ASCAP consent decree license. On September 17, 2013, our motion for partial summary judgment was granted, alleviating the need to negotiate direct licenses for such purportedly withdrawn performance rights. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014 and the court issued its opinion in March 2014. On April 14, 2014, ASCAP filed a notice of appeal of the District Court's decision with the Second Circuit Court of Appeals.

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On June 13, 2013, Broadcast Music, Inc. ("BMI") filed a petition in the rate court established by the consent decree between BMI and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2014. We filed our response on July 19, 2013. On November 1, 2013, we filed a motion for partial summary judgment seeking a determination that as a matter of law the publishers alleged to have withdrawn certain rights of public performance by digital audio transmission from the scope of grant of rights BMI could license on behalf of such publishers subsequent to the date of our request for a license from BMI were not valid as to our BMI consent decree license. On December 18, 2013, our motion for summary judgment was denied.

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 performance of sound recordings recorded prior to February 15, 1972.

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

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.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements — Continued

6. Other Long-Term Assets

	As of December 31, 2013	As of June 30, 2014
	(in thousands)	
Other long-term assets:		
Patents, net of amortization	\$ 7,636	\$ 7,273
Long-term security deposits	4,736	4,889
Other	1,343	1,539
Total other long-term assets	<u>\$ 13,715</u>	<u>\$ 13,701</u>

Pending Acquisition

In June 2013, we entered into a local marketing agreement to program KXMZ-FM, a Rapid City, South Dakota-area terrestrial radio station. In addition, we entered into an agreement to purchase the assets of KXMZ-FM for a total purchase price of approximately \$0.6 million in cash, subject to certain closing conditions. As of June 30, 2014, we have paid \$0.4 million of the purchase price, which is included in the other long-term assets line item of our balance sheets.

The completion of the KXMZ-FM acquisition is subject to various closing conditions, which include, but are not limited to, regulatory approval by the Federal Communications Commission. Upon completion of these conditions, we expect to account for this acquisition as a business combination.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

7. Debt Instruments

We are party to a \$60.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. The interest rate on borrowings is either LIBOR plus 2.00% - 2.25% or an alternate base rate plus 1.00% - 1.25%, both of which are per annum rates based on outstanding borrowings. The amount of borrowings available under the credit facility at any time is based on our monthly accounts receivable balance at such time, and the amounts borrowed are collateralized by our personal property (including such accounts receivable but excluding intellectual property). Under the credit facility, we can request up to \$15.0 million in letters of credit be issued by the financial institutions.

The credit facility contains customary events of default, conditions to borrowing and covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur debt, incur liens and make distributions to stockholders. The credit facility also includes a financial covenant requiring the maintenance of minimum liquidity of at least \$5.0 million. During the continuance of an event of a default, the lenders may accelerate amounts outstanding, terminate the credit facility and foreclose on all collateral.

As of June 30, 2014, we had no borrowings outstanding, \$1.1 million in letters of credit outstanding and \$58.9 million of available borrowing capacity under the credit facility.

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

8. Stock-based Compensation Plans and Awards

Employee Stock Purchase Plan

In December 2013, our board of directors approved the Employee Stock Purchase Plan ("ESPP"), which was approved by our stockholders at the annual meeting in June 2014. The ESPP allows eligible employees to purchase shares of our common stock through payroll deductions of up to 15% of their eligible compensation, subject to a maximum of \$25,000 per calendar year. Shares reserved for issuance under the ESPP include 4,000,000 shares of common stock. The ESPP provides for six-month offering periods, and the first offering period commenced in February 2014. At the end of each offering period employees are able to purchase shares at 85% of the lower of the fair market value of our common stock on the first trading day of the offering period or on the last day of the offering period.

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 per-share fair value of shares to be granted under the ESPP is determined on the first day of the offering period using the Black-Scholes option pricing model using the following assumptions:

	Three months ended June 30,		Six months ended June 30,	
	2013	2014	2013	2014
Expected life (in years)	N/A	0.5	N/A	0.5
Risk-free interest rate	N/A	0.08%	N/A	0.08%
Expected volatility	N/A	42%	N/A	42%
Expected dividend yield	N/A	0%	N/A	0%

During the three and six months ended June 30, 2014, we withheld \$1.6 million and \$2.5 million in contributions from employees and recognized \$0.6 million and \$0.9 million of stock-based compensation expense related to the ESPP. No shares of common stock were issued under the ESPP in the three and six months ended June 30, 2014.

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, 2013 and 2014, we recorded stock-based compensation expense from stock options of approximately \$3.3 million and \$3.7 million. During the six months ended June 30, 2013 and 2014, we recorded stock-based compensation expense from stock options of approximately \$5.0 million and \$7.2 million.

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The per-share fair value of each stock option was determined on the grant date using the Black-Scholes option pricing model using the following assumptions. There were no stock options issued during the three months ended June 30, 2014.

	Three months ended June 30,		Six months ended June 30,	
	2013	2014	2013	2014
Expected life (in years)	6.08	N/A	5.99 - 6.32	6.08
Risk-free interest rate	1.08%	N/A	0.99 - 1.19%	1.71 - 1.82%
Expected volatility	59%	N/A	57 - 59%	59%
Expected dividend yield	0%	N/A	0%	0%

Restricted stock units

The fair value of the restricted stock units ("RSUs") is expensed ratably over the vesting period. RSUs vest annually on a cliff basis over the service period, which is generally four years. During the three months ended June 30, 2013 and 2014, we recorded stock-based compensation expense from RSUs of approximately \$6.8 million and \$16.3 million. During the six months ended June 30, 2013 and 2014, we recorded stock-based compensation expense from RSUs of approximately \$11.7 million and \$29.9 million.

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,		Six months ended June 30,	
	2013	2014	2013	2014
	(in thousands) (unaudited)		(in thousands) (unaudited)	
Stock-based compensation expense:				
Cost of revenue - Other	\$ 482	\$ 1,032	\$ 895	\$ 1,913
Product development	2,394	4,426	3,839	7,887
Sales and marketing	5,027	9,922	9,448	18,233
General and administrative	2,235	5,233	2,480	9,972
Total stock-based compensation expense	<u>\$ 10,138</u>	<u>\$ 20,613</u>	<u>\$ 16,662</u>	<u>\$ 38,005</u>

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Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

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 and restricted stock units, to the extent dilutive. Basic and diluted net loss per share were the same for the three and six months ended June 30, 2013 and 2014, as the inclusion of all potential common shares outstanding would have been anti-dilutive.

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,	
	2013	2014	2013	2014
	(in thousands except per share amounts)		(in thousands except per share amounts)	
Numerator:				
Net loss	<u>\$ (6,902)</u>	<u>\$ (11,728)</u>	<u>\$ (45,588)</u>	<u>\$ (40,659)</u>
Denominator:				
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	<u>174,789</u>	<u>205,706</u>	<u>173,766</u>	<u>202,798</u>
Net loss per share, basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>	<u>\$ (0.26)</u>	<u>\$ (0.20)</u>

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,	
2013	2014
(in thousands)	

Options to purchase common stock	24,422	12,647
Restricted stock units	9,705	11,797
Total common stock equivalents	34,127	24,444

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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 Transition Report on Form 10-K for the eleven months ended December 31, 2013 filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act").

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

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

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Overview

Pandora is the leader in internet radio in the United States, offering a personalized experience for each of our listeners wherever and whenever they want to listen to radio on a wide range of smartphones, tablets, traditional computers and car audio systems, as well as a range of other internet-connected devices. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We have pioneered a new form of radio—one that uses intrinsic qualities of music to initially create stations and then adapts playlists in real-time based on the individual feedback of each listener. We offer local and national advertisers an opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements.

As of June 30, 2014, we had more than 250 million registered users, and more than 200 million registered users had accessed Pandora through smartphones and tablets. For the three months ended June 30, 2014, we streamed 5.04 billion hours of radio, and as of June 30, 2014, we had 76.4 million active users during the prior 30 day period. According to an April 2014 report by Triton, we have more than a 70% share of internet radio among the top 20 stations and networks in the United States. Since we launched our free, advertising-supported radio service in 2005 our listeners have created over 6 billion stations.

At the core 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 125,000 artists, spanning over 550 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 or genre to start a station, the Pandora service instantly generates a station that plays music we think that listener will enjoy. Based on listener reactions to the songs we stream, we further tailor the station to match the listener's preferences in real time.

We currently provide the Pandora service through two models:

- *Free Service.* Our free service is advertising-based 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 provided to paying subscribers without any external advertising. Pandora One enables listeners to create more stations, have more daily skips and enjoy higher quality audio on supported devices.

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 traditional computers, we have developed Pandora mobile device applications or “apps” for smartphones such as 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, Pandora is now integrated with more than 1,000 connected devices, including automobiles, automotive aftermarket devices and consumer electronic devices.

Recent Events

In November 2012, we filed a petition in the rate court established by the consent decree between ASCAP and the U.S. Department of Justice in the U.S. District Court for the Southern District of New York for the determination of reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014, and in March 2014, the court issued its opinion establishing a royalty rate of 1.85% of revenue for the entire license period. This opinion did not have a material impact on our condensed consolidated statements of operations. For the three and six months ended June 30, 2014, we incurred content acquisition costs for the public performance of musical works, including those we pay to other performing rights organizations (“PROs”) such as BMI and SESAC, representing approximately 4% of our total revenue. Refer to “Factors Affecting our Business Model” below for further details regarding royalties paid to PROs.

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Effective in March 2014, we implemented a change in the pricing structure for Pandora One under which the \$36 annual subscription option was eliminated. In addition, effective in May 2014, the monthly pricing option for Pandora One was increased to \$4.99 per-month for new subscribers. Existing monthly subscribers who did not lapse maintained the \$3.99 per-month pricing structure, and existing annual subscribers who did not lapse were migrated to the \$3.99 per-month monthly pricing structure.

An important element of our strategy to achieve greater penetration of the local radio advertising market is to have Pandora’s audience data presented in a manner consistent with similar data on terrestrial radio stations so that advertisers and advertising agencies can better evaluate the relative value proposition of advertising on Pandora. In February 2014, Triton received Media Rating Council (“MRC”) accreditation for its Webcast Metrics Local (“WCML”) product, which allows agencies and advertisers to evaluate Pandora’s relative audience scale using broadcast metrics in specific advertising markets. Also in February 2014, we completed the WCML publisher audit of our user-declared geographic and demographic listener data. We believe this accreditation validates that our local audience metrics are reliable and effective.

Factors Affecting our Business Model

As our mobile listenership increases, we face new challenges in optimizing our advertising products for delivery on mobile and other connected device platforms and monetizing inventory generated by listeners using these platforms. The mobile digital advertising market is at an early stage of development, with lower overall spending levels than traditional online advertising markets, and faces technical challenges due to fragmented platforms and a lack of standard audience measurement protocols. As a greater share of our listenership is consumed on mobile devices, our ability to monetize increased mobile streaming may not keep up with our past monetization of streaming to desktop computers and laptops.

In addition, our monetization strategy includes increasing the number of ad campaigns for traditional computer, mobile and other connected device platforms sold to local advertisers, placing us in more direct competition with broadcast radio for advertiser spending, especially for audio advertisements. By contrast, historically our display advertisers have been predominantly national brands. To successfully monetize our growing listener hours, a key strategy is 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, and in particular, audio advertising products, across the range of our delivery platforms.

Growth in our active users and distribution platforms has fueled a corresponding growth in listener hours. Our total number of listener hours is a key driver for both revenue generation opportunities and content acquisition 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. In turn, our ability to generate revenue depends on the extent to which we are able to sell the inventory we have.
- *Cost of Revenue—Content Acquisition Costs.* The number of sound recordings we transmit to users of the Pandora service, as generally reflected by listener hours, drives substantially all 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.

We pay royalties to the copyright owners, or their agents, of each sound recording that we stream and to the copyright owners, or their agents, of the musical work embodied in that sound recording, subject to certain exclusions. Royalties for sound recordings are negotiated with and paid to record labels or to SoundExchange, a PRO authorized to collect royalties on behalf of all sound recording copyright owners. Royalties for musical works are most often negotiated with and paid to PROs such as ASCAP, BMI and SESAC or directly to publishing companies. Royalties are calculated based on the number of sound recordings streamed, revenue earned or other usage measures.

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We stream spoken word comedy content pursuant to a federal statutory license, for which the underlying literary works are not currently entitled to eligibility for licensing by any PRO for the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such PRO or the copyright owner of such content. However, we pay royalties to SoundExchange at rates negotiated between representatives of online music services and SoundExchange for the right to stream this spoken word comedy content.

Given the current royalty structures in effect through 2015 with respect to the public performance of sound recordings in the United States, 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 depends on our ability to increase our revenue per hour of streaming through increased advertising sales across all of our delivery platforms.

In addition, we expect to invest heavily in our operations to support anticipated future growth. One of our key objectives is furthering our market leadership in internet radio, 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 matures, we expect that our revenue growth will exceed the growth in our listener hours. However, we expect to incur annual net losses on a U.S. GAAP basis in the near term because our current strategy is to leverage any improvements in gross profit by investing in broadening distribution channels, developing innovative and scalable advertising products, increasing utilization of advertising inventory and building our sales force. These investments are intended to drive further growth in our business through both increased listener hours and monetization of those hours, and as a result we are targeting gradual improvements in gross profit over time. Our planned reinvestment of any resulting incremental gross profit will continue to depress any growth of bottom line profitability.

Key Metrics

Listener Hours

The table below sets forth our listener hours for the three and six months ended June 30, 2013 and 2014.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2013	2014	2013	2014
	(in billions)		(in billions)	
Listener hours	3.91	5.04	8.17	9.84

We track listener hours because it is a key indicator of the growth of our business. 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. 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.

Active Users

The table below sets forth our active users as of December 31, 2013 and June 30, 2014.

	As of	As of
	December 31,	June 30,
	2013	2014
	(in millions)	
Active users	76.2	76.4

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We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time. Active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts.

Advertising Revenue per Thousand Listener Hours ("ad RPMs")

The table below sets forth our ad RPMs, including total, traditional computer and mobile and other connected devices ad RPMs for the three and six months ended June 30, 2013 and 2014.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2013	2014	2013	2014
Total ad RPMs	\$ 37.89	\$ 40.11	\$ 30.90	\$ 36.83
Traditional computer	58.53	62.43	51.48	57.50
Mobile and other connected devices	32.56	36.00	25.97	32.84

We track ad RPMs for our free, advertising supported service because it is a key indicator of our ability to monetize advertising inventory created by our listener hours. We focus on total ad RPMs across all of our delivery platforms. Ad RPMs compare advertising revenue generated in a given period to advertising supported listener hours in the period and we believe such total ad RPMs to be the central top-line indicator for evaluating the results of our monetization efforts. We calculate total ad RPMs by dividing advertising revenue we generate by the number of thousands of listener hours of our

advertising-based service.

We also provide estimates of disaggregated ad RPMs for our traditional computer platform as well as our mobile and other connected devices platforms, which we calculate by dividing the estimated advertising revenue generated through the respective platforms by the number of thousands of listener hours of our advertising-based service delivered through such platforms. While we believe that such disaggregated ad RPMs provide directional insight for evaluating our efforts to monetize our service by platform, we do not validate disaggregated ad RPMs to the level of financial statement reporting. Such metrics should be seen as indicative only and as management's best estimate. We continue to refine our systems and methodologies used to categorize ad RPMs across our delivery platforms. 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.

Total ad RPMs.

For the three and six months ended June 30, 2013 compared to 2014, total ad RPMs increased as advertising sales growth outpaced the growth in advertising-supported listener hours primarily due to an increase in the average price per ad.

Traditional computer ad RPMs.

For the three and six months ended June 30, 2013 compared to 2014, traditional computer ad RPMs increased as the growth in traditional computer revenue outpaced the growth in listener hours on that platform primarily due to an increase in the average price per traditional computer ad.

Mobile and other connected device ad RPMs.

For the three and six months ended June 30, 2013 compared to 2014, mobile and other connected device ad RPMs increased as the growth in mobile and other connected devices revenue outpaced the growth in listening hours on those platforms due to an increase in the average price per mobile ad.

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Total Revenue per Thousand Listener Hours ("total RPMs")

The table below sets forth our total RPMs, including total, traditional computer and mobile and other connected devices total RPMs for the three and six months ended June 30, 2013 and 2014.

	Three months ended June 30,		Six months ended June 30,	
	2013	2014	2013	2014
Total RPMs	\$ 39.17	\$ 43.41	\$ 32.79	\$ 42.00
Traditional computer	56.73	61.01	50.90	57.66
Mobile and other connected devices	34.37	39.88	28.07	38.70

We track total revenue per thousand listener hours for our service because it is a key indicator of our ability to monetize our listener hours. We focus on total RPMs across all of our delivery platforms. Total RPMs compare advertising and subscription and other revenue generated in a given period to total listener hours in the period. We calculate total RPMs by dividing the total revenue generated by the number of thousands of listener hours.

The estimates used to derive disaggregated total RPMs for our traditional computer platform, as well as our mobile and other connected devices platforms, are similar to those used to derive ad RPMs. The changes in total RPMs were driven by the same factors mentioned above within the discussion of ad RPMs. In addition, the changes in total RPMs for the six months ended June 30, 2014 reflect a \$14.2 million increase in subscription revenue in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to "Deferred Revenue" below for further details regarding these in-app subscriptions.

Licensing Costs per Thousand Listener Hours ("LPMs")

The table below sets forth our total LPMs for the three and six months ended June 30, 2013 and 2014.

	Three months ended June 30,		Six months ended June 30,	
	2013	2014	2013	2014
Total LPMs	\$ 20.40	\$ 22.10	\$ 20.30	\$ 22.30

We track licensing costs per thousand listener hours 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 increases 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. Total LPMs in the three and six months ended June 30, 2014 increased compared to the respective prior year periods primarily due to scheduled rate increases for sound recording royalties paid to SoundExchange.

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Basis of Presentation and Results of Operations

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,		Six months ended June 30,	
	2013	2014	2013	2014
Revenue:				
Advertising	83%	81%	84%	77%
Subscription and other	17	19	16	23
Total revenue	100	100	100	100
Cost of revenue:				
Cost of revenue — Content acquisition costs	52	51	62	53
Cost of revenue — Other(1)	7	6	8	7
Total cost of revenue	59	57	70	60
Gross profit	41	43	30	40
Operating expenses:				
Product development(1)	5	6	5	6
Sales and marketing(1)	29	30	31	31
General and administrative(1)	11	12	11	13
Total operating expenses	45	48	47	50
Loss from operations	(4)	(5)	(17)	(10)
Other income (expense), net	—	—	—	—
Loss before provision for income taxes	(4)	(5)	(17)	(10)
Provision for income taxes	—	—	—	—
Net Loss	(4)%	(5)%	(17)%	(10)%

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	0.3%	0.5%	0.3%	0.5%
Product development	1.6	2.0	1.4	1.9
Sales and marketing	3.3	4.5	3.5	4.4
General and administrative	1.5	2.4	0.9	2.4

Revenue.

	Three months ended June 30,			Six months ended June 30,		
	2013	2014	\$ Change	2013	2014	\$ Change
	(in thousands)			(in thousands)		
Advertising	\$ 127,555	\$ 177,324	\$ 49,769	\$ 224,269	\$ 317,958	\$ 93,689
Subscription and other	25,549	41,570	16,021	43,959	95,251	51,292
Total revenue	\$ 153,104	\$ 218,894	\$ 65,790	\$ 268,228	\$ 413,209	\$ 144,981

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, 2013 and 2014 and the six months ended June 30, 2013 and 2014, advertising revenue accounted for 83%, 81%, 84% and 77%, of our total revenue, respectively. We expect that advertising will comprise a substantial majority of revenue for the foreseeable future.

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For the three months ended June 30, 2013 compared to 2014, advertising revenue increased \$49.8 million or 39%, primarily due to an approximate 25% increase in the average price per ad and an approximate 10% increase in the number of ads sold due to our focus on monetizing mobile inventory.

For the six months ended June 30, 2013 compared to 2014, advertising revenue increased \$93.7 million or 42%, primarily due to an approximate 35% increase in the average price per ad and an approximate 5% increase in the number of ads sold due to 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, 2013 and 2014 and the six months ended June 30, 2013 and 2014, subscription and other revenue accounted for 17%, 19%, 16% and 23% of our total revenue, respectively.

Effective in March 2014, we implemented a change in the pricing structure for Pandora One under which the \$36 annual subscription option was eliminated. In addition, effective in May 2014, the monthly pricing option for Pandora One was increased to \$4.99 per-month for new subscribers. Existing monthly subscribers who did not lapse maintained the \$3.99 per-month pricing structure, and existing annual subscribers who did not lapse were migrated to the \$3.99 per-month monthly pricing structure.

For the three months ended June 30, 2013 compared to 2014, subscription revenue increased \$16.0 million or 63%, primarily due to an approximate 40% increase in the average price per subscription as a result of the change in the Pandora One pricing structure and due to an approximate 15% increase in the number of subscribers.

For the six months ended June 30, 2013 compared to 2014, subscription revenue increased \$51.3 million or 117%, primarily due to an approximate 40% increase in the average price per subscription as a result of the change in the Pandora One pricing structure and due to an approximate 15% increase in the number of subscribers. The increase in subscription revenue for the six months ended June 30, 2014 was also due to a \$14.2 million increase in subscription revenue in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to “Deferred Revenue” below for further details regarding these in-app subscriptions.

Deferred revenue.

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

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

We were required to defer revenue for certain in-app mobile subscriptions that contained refund rights until the refund rights lapsed or until we developed sufficient operating history to estimate a return reserve. As of December 31, 2013, we had deferred all revenue related to these in-app mobile subscriptions subject to refund rights totaling approximately \$14.2 million, as we did not have sufficient transaction history to estimate a return reserve. Beginning in January 2014, we had sufficient transaction history that enabled us to estimate future returns. Accordingly, in January 2014, we began recording revenue related to these in-app mobile subscriptions net of estimated returns. This resulted in a one-time increase in subscription revenue in the three months ended March 31, 2014 of approximately \$14.2 million, as the previously deferred revenue was recognized. As of June 30, 2014, the deferred revenue related to the return reserve was not significant.

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Deferred revenue in our condensed consolidated balance sheet as of June 30, 2014 decreased as compared to December 31, 2013 in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions in the three months ended March 31, 2014. In addition, deferred revenue also decreased due to the elimination of the annual pricing option, as we collected less cash upfront under the one-month subscription period as opposed to the twelve-month subscription period under the annual subscription option.

Costs and Expenses

Cost of revenue consists of cost of revenue — content acquisition costs and cost of revenue — other. 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,		
	2013	2014	\$ Change		2013	2014	\$ Change
	(in thousands)				(in thousands)		
Cost of revenue - content acquisition costs	\$ 79,828	\$ 111,461	\$ 31,633		\$ 165,651	\$ 219,736	\$ 54,085

Content acquisition costs as a percentage of advertising revenue by platform

	Three months ended June 30,			Six months ended June 30,		
	2013	2014		2013	2014	
Traditional computer	32%	34%		37%	37%	
Mobile and other connected devices	55%	56%		71%	61%	

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 and are based on both percentage of revenue and listening metrics. 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 or a formula that involves a combination of per performance and revenue metrics. For royalty arrangements under negotiation, we accrue for estimated royalties based on the available facts and circumstances and adjust these estimates as more information becomes available. The results of any finalized negotiation may be materially different from our estimates.

We estimate our advertising-based content acquisition costs attributable to specific platforms by allocating costs from royalties payable based on a fee per track to the platform for which the track is served and by allocating costs from royalties based on a percentage of our revenue in accordance with the overall percentage of our revenue estimated to be attributable to such platforms. While we believe that comparing disaggregated content acquisition costs and revenues across our delivery platforms may provide directional insight for evaluating our efforts to monetize the rapid adoption of our service on mobile

and other connected devices, we do not validate such disaggregated metrics to the level of financial statement reporting. We continue to refine our systems and methodologies used to categorize such metrics across our delivery platforms and the period-to-period comparisons of results are not necessarily indicative of results for future periods.

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For the three months ended June 30, 2013 compared to 2014, content acquisition costs increased \$31.6 million or 40%, primarily due to a 29% increase in listener hours and scheduled royalty rate increases of 8%. Content acquisition costs as a percentage of total revenue decreased from 52% to 51%, primarily due to an increase in advertising sales. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our traditional computer platform increased from 32% to 34%, primarily due to scheduled royalty rate increases and an increase in listener hours, partially offset by an increase in advertising sales on the traditional computer platform as a result of an increase in the average price per ad. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our mobile and other connected devices platforms increased from 55% to 56%, primarily due to scheduled royalty rate increases and an increase in listener hours, partially offset by an increase in advertising sales on the mobile and other connected devices platforms as a result of an increase in the average price per ad.

For the six months ended June 30, 2013 compared to 2014, content acquisition costs increased \$54.1 million or 33%, primarily due to a 20% increase in listener hours and scheduled royalty rate increases of 8%. Content acquisition costs as a percentage of total revenue decreased from 62% to 53%, primarily due to an increase in advertising sales and a \$14.2 million increase in subscription revenue in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to “Deferred Revenue” above for further details regarding these in-app subscriptions. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our traditional computer platform were 37% in both the six months ended June 30, 2013 and 2014, primarily due to an increase in advertising sales on the traditional computer platform that were offset by scheduled rate increases and an increase in listener hours. Estimated content acquisition costs as a percentage of the advertising revenue attributable to our mobile and other connected devices platforms decreased from 71% to 61%, primarily due to an increase in advertising sales on the mobile and other connected devices platforms, and the effect of measures we have adopted to manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience, partially offset by scheduled rate increases.

Cost of revenue—other.

	Three months ended June 30,			Six months ended June 30,		
	2013	2014 (in thousands)	\$ Change	2013	2014 (in thousands)	\$ Change
Cost of revenue — other	\$ 10,847	\$ 13,989	\$ 3,142	\$ 20,623	\$ 28,968	\$ 8,345

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

For the three months ended June 30, 2013 compared to 2014, cost of revenue increased \$3.1 million or 29%, primarily due to a \$1.6 million increase in employee-related costs driven by an approximate 50% increase in headcount and a \$0.9 million increase in hosting and infrastructure costs driven by an increase in listener hours.

For the six months ended June 30, 2013 compared to 2014, cost of revenue increased \$8.3 million or 40%, primarily due to a \$2.8 million increase in employee-related costs and a \$1.2 million increase in facilities and equipment expenses, both of which were driven by an approximate 50% increase in headcount, a \$2.3 million increase in other costs of ad sales related to events sold as part of advertising arrangements and a \$2.1 million increase in hosting and infrastructure costs driven by an increase in listener hours.

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Gross profit

	Three months ended June 30,			Six months ended June 30,		
	2013	2014 (in thousands)	\$ Change	2013	2014 (in thousands)	\$ Change
Total revenue	\$ 153,104	\$ 218,894	\$ 65,790	\$ 268,228	\$ 413,209	\$ 144,981
Total cost of revenue	90,675	125,450	34,775	186,274	248,704	62,430
Gross profit	\$ 62,429	\$ 93,444	\$ 31,015	\$ 81,954	\$ 164,505	\$ 82,551
Gross margin	41%	43%		31%	40%	

For the three months ended June 30, 2013 compared to 2014, gross profit increased by \$31.0 million or 50%, primarily due to an increase in advertising revenue as a result of an increase in the average price per ad. Gross margin increased from 41% to 43% as the growth in revenue outpaced the growth in content acquisition costs primarily due to an increase in advertising sales and the effect of measures we have adopted to manage the growth of mobile content acquisition costs while minimizing adverse effects on the listener experience.

For the six months ended June 30, 2013 compared to 2014, gross profit increased by \$82.6 million or 101%, primarily due to an increase in advertising revenue as a result of an increase in the average price per ad. Gross margin increased from 31% to 40% as the growth in revenue outpaced the growth in content acquisition costs primarily due to an increase in advertising sales and the effect of measures we have adopted to manage the growth of mobile content

acquisition costs while minimizing adverse effects on the listener experience. The increase in gross margin was also due to an increase in subscription and other revenue driven by a \$14.2 million increase in connection with the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions. Refer to “Deferred Revenue” above for further details regarding these in-app subscriptions.

Product development

	Three months ended June 30,			Six months ended June 30,		
	2013	2014	\$ Change	2013	2014	\$ Change
	(in thousands)			(in thousands)		
Product development	\$ 7,895	\$ 13,076	\$ 5,181	\$ 14,562	\$ 24,907	\$ 10,345

Product development consists primarily of employee-related costs, including salaries and benefits related to employees in software engineering, music analysis and product management departments, facilities-related expenses, information technology and costs associated with supporting consumer connected-device manufacturers in implementing our service in their products. We incur product development expenses primarily for improvements to our website and the Pandora app, development of new advertising products and development and enhancement of our personalized station generating system. We have generally expensed product development as incurred. Certain website development and internal use software development costs may be 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 intend to continue making significant investments in developing new products and enhancing the functionality of our existing products.

For the three months ended June 30, 2013 compared to 2014, product development expenses increased \$5.2 million or 66%, primarily due to a \$4.8 million increase in employee-related costs driven by an approximate 50% increase in headcount.

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For the six months ended June 30, 2013 compared to 2014, product development expenses increased \$10.3 million or 71%, primarily due to a \$9.4 million increase in employee-related costs driven by an approximate 50% increase in headcount.

Sales and marketing

	Three months ended June 30,			Six months ended June 30,		
	2013	2014	\$ Change	2013	2014	\$ Change
	(in thousands)			(in thousands)		
Sales and marketing	\$ 44,371	\$ 66,232	\$ 21,861	\$ 82,416	\$ 128,096	\$ 45,680

Sales and marketing consists primarily of employee-related costs, including salaries, commissions and benefits related to employees in sales, sales support and marketing departments. In addition, sales and marketing expenses include transaction processing commissions on subscription purchases on mobile platforms, external sales and marketing expenses such as third-party marketing, branding, advertising and public relations expenses, facilities-related expenses, infrastructure costs and credit card fees. We expect sales and marketing expenses to increase as we hire additional personnel to build out our sales and sales support teams, particularly as we build out our local market sales team.

For the three months ended June 30, 2013 compared to 2014, sales and marketing expenses increased \$21.9 million or 49%, primarily due to a \$15.9 million increase in employee-related costs driven by an approximate 35% increase in headcount, a \$3.0 million increase in marketing expenses and a \$2.1 million increase in transaction processing commissions on subscription purchases on mobile platforms.

For the six months ended June 30, 2013 compared to 2014, sales and marketing expenses increased \$45.7 million or 55%, primarily due to a \$32.1 million increase in employee-related costs and a \$2.6 million increase in facilities and equipment expenses, both of which were driven by an approximate 35% increase in headcount, a \$6.2 million increase in transaction processing commissions on subscription purchases on mobile platforms and a \$5.0 million increase in marketing expenses.

General and administrative

	Three months ended June 30,			Six months ended June 30,		
	2013	2014	\$ Change	2013	2014	\$ Change
	(in thousands)			(in thousands)		
General and administrative	\$ 16,931	\$ 25,865	\$ 8,934	\$ 30,286	\$ 52,226	\$ 21,940

General and administrative consists primarily of employee-related costs, including salaries and benefits 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, facilities-related expenses and infrastructure costs. 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.

For the three months ended June 30, 2013 compared to 2014, general and administrative expenses increased \$8.9 million or 53%, primarily due to a \$5.8 million increase in employee-related costs and a \$1.0 million increase in facilities and equipment expenses, both of which were driven by an approximate 45% increase in headcount, and a \$1.1 million increase in professional services costs related to litigation and royalty-related matters.

For the six months ended June 30, 2013 compared to 2014, general and administrative expenses increased \$21.9 million or 72%, primarily due to a \$13.0 million increase in employee-related costs and a \$1.9 million increase in facilities and equipment expenses, both of which were driven by an approximate 45% increase in headcount and a \$5.1 million increase in professional services costs related to litigation and royalty-related matters.

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Income tax benefit (expense)

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

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

Off-Balance Sheet Arrangements

Our liquidity is not dependent on the use of off-balance sheet financing arrangements and as of June 30, 2014 we had no such arrangements. There has been no material change in our contractual obligations other than in the ordinary course of business since the eleven months ended December 31, 2013.

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.

Our results reflect the effects of seasonal trends in listener behavior. During the last three months of each calendar year, we experience higher advertising sales as a result of greater advertiser demand during the holiday season. We also experience lower advertising sales in the first three months of the calendar year due to reduced advertiser demand. In addition, we expect to experience increased usage during the last three months of each calendar year during the holiday season, and in the first three months of each calendar year 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. We believe that our business may become more seasonal in the future and that such seasonal variations in listener behavior may result in fluctuations in our financial results.

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

Liquidity and Capital Resources

As of June 30, 2014, we had cash, cash equivalents and investments totaling \$437.9 million, which 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 six months ended June 30, 2014 were funding our operations, as described below, and capital expenditures.

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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

We are party to a \$60.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. Refer to Note 8 “Debt Instruments” in the Notes to Condensed Consolidated Financial Statements for further details regarding our credit facility.

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, 2013 and 2014.

**Six months ended
June 30,**

	2013	2014
	(in thousands) (unaudited)	
Net cash used in operating activities	\$ (17,503)	\$ (9,365)
Net cash used in investing activities	(8,355)	(93,602)
Net cash provided by financing activities	6,086	15,044

Operating activities

In the six months ended June 30, 2014, net cash used in operating activities was \$9.4 million and primarily consisted of our net loss of \$40.7 million, which was partially offset by non-cash charges of \$46.6 million, primarily related to \$38.0 million in stock-based compensation charges. Net cash used in operating activities also included a \$19.9 million decrease in deferred revenue from the prior period, primarily due to the one-time recognition of the accumulation of deferred revenue related to in-app subscriptions of \$14.2 million and due to a decrease in deferred revenue as a result of the elimination of the annual subscription option, as we collected less cash upfront under the one-month subscription period as opposed to the twelve-month subscription period under the annual subscription option. Cash used in operating activities decreased \$8.1 million from the six months ended June 30, 2013 primarily due to a \$4.9 million decrease in our net loss.

Investing activities

In the six months ended June 30, 2014, net cash used in investing activities was \$93.6 million, primarily due to \$194.1 million for purchases of investments and \$16.3 million for capital expenditures for leasehold improvements and server equipment, partially offset by \$116.8 million in maturities of investments.

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Financing activities

In the six months ended June 30, 2014, net cash provided by financing activities was \$15.0 million, primarily consisting of \$12.6 million in proceeds from the issuance of common stock as a result of an increase in exercises of stock options related to the increase in our stock price.

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 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.

Other than those discussed below, there have been no material changes to our critical accounting policies and estimates as compared to those described in our Transition Report on Form 10-K for the eleven months ended December 31, 2013 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates.”

Deferred Revenue

We were required to defer revenue for certain in-app mobile subscriptions that contained refund rights until the refund rights lapsed or until we developed sufficient operating history to estimate a return reserve. As of December 31, 2013, we had deferred all revenue related to these in-app mobile subscriptions subject to refund rights totaling approximately \$14.2 million, as we did not have sufficient history to estimate a return reserve. Beginning in January 2014, we had sufficient historic transactional information which enabled us to estimate future returns. Accordingly, in January 2014, we began recording revenue related to these in-app mobile subscriptions net of estimated returns. This change resulted in a one-time increase in subscription revenue in the three months ended March 31, 2014 of approximately \$14.2 million, as the previously deferred revenue was recognized. As of June 30, 2014, the deferred revenue related to the return reserve was not significant.

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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 Transition Report on Form 10-K for the eleven months ended December 31, 2013. For further discussion of quantitative and qualitative disclosures about market risk, reference is made to our Transition Report on Form 10-K.

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, 2014.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting 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.

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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 Transition Report on Form 10-K for the eleven months ended December 31, 2013 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 Transition Report on Form 10-K for the eleven months ended December 31, 2013, other than as set forth below. The risk factors below, all of which originally appear in our Transition Report on Form 10-K, have been updated to reflect additional information regarding third party measurement, royalties and litigation, among other things.

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

Selling ads, locally and nationally, requires that we demonstrate to advertisers that our service has substantial reach and usage. Third-party measurements may not reflect our true listening audience and their underlying methodologies are subject to change at any time. In addition, the methodologies we apply to measure the key metrics that we use to monitor and manage our business may differ from the methodologies used by third-party measurement service providers. For example, 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. By contrast, certain third-party measurement service providers may calculate and report the number of listener hours using a client-based approach, which measures time elapsed during listening sessions. Measurement technologies for mobile and consumer electronic devices may be even less reliable in quantifying the reach, usage and location of our service, and it is not clear whether such technologies will integrate with our systems or uniformly and comprehensively reflect the reach, usage and location of our service. While we have been working with third-party measurement service providers and earning Media Ratings Council accreditation for these measurements, some providers have not yet developed uniform measurement systems that comprehensively measure the reach, usage and location of our service. In order to demonstrate to potential advertisers the benefits of our service, we must supplement third-party measurement data with our internal research, which may be perceived as less valuable than third-party numbers. If such third-party measurement providers report lower metrics than we do, or if there is wide variance among reported metrics, our ability to convince advertisers of the benefits of our service could be adversely affected.

The lack of accurate cross-platform measurements for internet radio and broadcast radio may adversely affect our ability to grow advertising revenue.

Pandora has invested substantial resources to create accurate cross-platform measurements for internet radio and broadcast radio in the major automated media-buying platforms, creating a one-stop shop that enables media buyers to compare internet radio audience reach with terrestrial radio audience reach using traditional broadcast radio metrics. To achieve this result, we currently rely on third parties such as Triton to quantify the reach and usage of our service and on media buying companies to provide Internet radio metrics side-by-side with terrestrial radio metrics in media-buying platforms.

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We have also partnered with media buying companies that show internet radio measurements alongside terrestrial metrics in the media buying systems that media buyers use to purchase advertising. Media buying companies receive measurement metrics from third parties, such as Triton for internet radio and Nielsen for more traditional media like terrestrial radio and television. Media buying companies may choose not to show, or may be prohibited by third-party measurement services that measure terrestrial radio and other traditional media from showing, internet radio metrics alongside traditional terrestrial metrics. Our ability to realize our long-term potential will be significantly affected by our success in these advertising initiatives, and there is no assurance we will

achieve substantial penetration of these advertising markets.

We depend upon third-party licenses for the right to publicly perform musical works and a change to these licenses could materially increase our content acquisition costs.

Our content costs, in part, are comprised of the royalties we pay for the public performance of musical works embodied in the sound recordings that we stream. As described in “Business—Content, Copyrights and Royalties—Musical Works” in our Transition Report on Form 10-K for the eleven months ended December 31, 2013, to secure the rights to publicly perform musical works embodied in sound recordings over the internet, we obtain licenses from or for the benefit of copyright owners and pay royalties to copyright owners or their agents. Copyright owners of musical works are vigilant in protecting their rights and currently are seeking substantial increases in the rates applicable to the public performance of such works. There is no guarantee that the licenses available to us now will continue to be available in the future or that such licenses will be available at the royalty rates associated with the current licenses. If we are unable to secure and maintain rights to publicly perform musical works or if we cannot do so on terms that are acceptable to us, our ability to perform music content to our listeners, and consequently our ability to attract and retain both listeners and advertisers, will be adversely impacted.

Copyright owners of musical works, typically, songwriters and music publishers, have traditionally relied on intermediaries known as performing rights organizations to negotiate so-called “blanket” licenses with copyright users, collect royalties under such licenses, and distribute them to copyright owners. We have obtained public performance licenses from, and pay license fees to, the three major performing rights organizations in the United States: the American Society of Composers, Authors and Publishers (“ASCAP”), Broadcast Music, Inc. (“BMI”) and SESAC, Inc. (“SESAC”).

We currently operate under interim licenses with each of ASCAP and BMI. ASCAP and BMI each are governed by a consent decree with the United States Department of Justice. The rates we pay ASCAP and BMI can be established by either negotiation or through a rate court proceeding conducted by the United States District Court for the Southern District of New York. We elected to terminate our prior agreements with ASCAP as of December 31, 2010 and with BMI as of December 31, 2012 because, among other things, we believed that the royalty rates sought by ASCAP and BMI were in excess of rates paid by our largest radio competitors, broadcast radio stations and satellite radio. Notwithstanding our termination of these agreements, the musical works administered by each of ASCAP and BMI continued to be licensed to us pursuant to the provisions of their respective consent decrees. In November 2012, we filed a petition requesting that the ASCAP rate court determine reasonable license fees and terms for the ASCAP consent decree license applicable to the period January 1, 2011 through December 31, 2015. In June 2013, BMI filed a petition requesting that the BMI rate court determine reasonable license fees and terms for the BMI consent decree license applicable to the period January 1, 2013 through December 31, 2017. A trial to determine the royalty rates we will pay ASCAP concluded in February 2014 and the court issued its opinion in March 2014, but ASCAP has appealed the decision and such appeal is pending. A trial date has not been set for the BMI rate court proceeding. Each of these proceedings has been, and is expected to continue to be, protracted, expensive and uncertain in outcome. It is likely that trial level outcomes will be appealed and the final resolution may not be known for years. In the event that these matters are resolved adversely to us, our content acquisition costs could increase significantly, which would adversely affect our operating results. Notwithstanding the ASCAP court decision, there is no guarantee that final rates established by mutual agreement or by a rate court determination would establish royalty rates more favorable to us than those we previously paid pursuant our terminated agreements with ASCAP and/or BMI or those that we pay pursuant to our interim arrangements with ASCAP and/or BMI. For the eleven months ended December 31, 2013, we incurred content acquisition costs for the public performance of musical works representing approximately 4% of our total revenue for that period.

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We currently operate under an agreement with SESAC, which automatically renews yearly, but is subject to termination by either party in accordance with its terms at the end of each yearly term. The SESAC rate is subject to small annual increases. There is no guarantee that either the license or the associated royalty rate available to us now with respect to SESAC will be available to us in the future.

We do not currently pay so-called “mechanical royalties” to music publishers for the reproduction and distribution of musical works embodied in server copies or transitory copies used to make streams audible to our listeners. Although not currently a matter of dispute, if music publishers were to retreat from the publicly stated position of their trade association that non-interactive streaming does not require the payment of a mechanical royalties, and a final judgment were entered by a court requiring that payment, our royalty obligations could increase significantly, which would increase our operating expenses and harm our business and financial interests. While we would vigorously challenge such mechanical royalties as not required by law, our challenge may be unsuccessful and would in any case involve commitment of substantial time and resources. In addition, we stream spoken word comedy content, for which the underlying literary works are not currently entitled to eligibility for licensing by any performing rights organization in the United States. Rather, pursuant to industry-wide custom and practice, this content is performed absent a specific license from any such performing rights organization or individual rights owners, although royalties are paid to SoundExchange for the public performance of the sound recordings in which such literary works are embodied. There can be no assurance that this industry custom will not change or that we will not otherwise become subject to additional licensing costs for spoken word comedy content imposed by performing rights organizations or individual copyright owners in the future or be subject to damages for copyright infringement.

Assertions by third parties of violations under state law with respect to the public performance and reproduction of pre-1972 sound recordings could result in significant costs and substantially harm our business and operating results.

As described in “Business—Content, Copyrights and Royalties—Sound Recordings” in our Transition Report on Form 10-K for the eleven months ended December 31, 2013, sound recordings made on or after February 15, 1972 fall within the scope of federal copyright protection. Subject to our ongoing compliance with numerous federal statutory conditions and regulatory requirements for a noninteractive service, we are permitted to operate our radio service under a statutory license that allows the streaming in the U.S. of any such sound recording lawfully released to the public and permits us to make reproductions of such sound recordings on computer servers pursuant to a separate statutory license designed to facilitate the making of such transmissions.

By contrast, protection of sound recordings created prior to February 15, 1972 (“pre-1972 sound recordings”) remains governed by a patchwork of state statutory and common laws. Copyright owners of pre-1972 sound recordings have commenced litigation against us, alleging violations of New York state statutory and common laws with respect to the unauthorized reproduction and public performance of pre-1972 sound recordings, seeking, among other things, restitution, disgorgement of profits, and punitive damages as well as injunctive relief prohibiting further violation of those copyright owners’ alleged exclusive rights. Litigation has been brought previously against Sirius XM Radio Inc. for similar claims. If we are found liable for the violation of the exclusive rights of any pre-1972 sound recording copyright owners, then we could be subject to liability, the amount of which could be significant. If we are required to obtain licenses from individual sound recording copyright owners for the reproduction and public performance of pre-1972 sound recordings,

then the time, effort and cost of securing such licenses directly from all owners of sound recording used on our service could be significant and could harm our business and operating results. If we are required to obtain licenses for pre-1972 sound recordings to avoid liability and are unable to secure such licenses, then we may have to remove pre-1972 sound recordings from our service, which could harm our ability to attract and retain users.

Our royalty payments are subject to audits and our royalty calculation methods involve significant estimates.

The royalties that we pay to SoundExchange for the streaming of sound recordings are calculated using a per performance rate. While we believe that the mechanisms we use to track performances are sufficient to ensure that we are accurately reporting and paying royalties, our ability to do so depends in part on our ability to maintain these mechanisms as new devices are introduced and technologies evolve. Any understatement or overstatement of performances could result in our paying lower or higher royalties to SoundExchange than we actually owed, which could in turn affect our financial condition and results of operations. SoundExchange has the right to audit our royalty payments and in December 2013 informed us that it intends to audit our payments for the years 2010, 2011, and 2012. In addition, performing rights organizations and musical work copyright owners with whom we have entered into direct licenses have or may have the right to audit our royalty payments, and any such audit could result in disputes over whether we have paid the proper royalties. If such a dispute were to occur, we could be required to pay additional royalties and audit fees. The amounts involved could be material.

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Rate court proceedings, the attempted and/or purported withdrawal of certain music publishers or the rights to certain of their works for certain purposes from ASCAP and BMI, and our recent entry into a local marketing agreement to program KXMZ-FM have highlighted uncertainties for the royalty rates that we pay for the public performance of musical works. For example, we could be liable for both increased royalty rates going forward and a potential true-up of royalty payments in excess of any interim royalties paid for the period following December 31, 2010 with respect to ASCAP if ASCAP successfully appeals the rate court's March 2014 ruling and/or for the period following December 31, 2012 with respect to BMI. We record a liability for public performance royalties based on our best estimate of the amount owed to each organization based on historical rates, third-party evidence and legal developments. For each quarterly period, we evaluate our estimates to assess the adequacy of recorded liabilities. If actual royalty rates differ from estimates, revisions to the estimated royalty liabilities may be required, which could materially affect our results of operations. Any royalty audit could result in disputes over whether we have paid the proper royalties.

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

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

If we or any of our processing vendors have problems with our billing software, or the billing software malfunctions, it could have an adverse effect on our subscriber satisfaction and could cause one or more of the major credit card companies to disallow our continued use of their payment products. In addition, if our billing software fails to work properly and, as a result, we do not automatically charge our subscribers' credit cards on a timely basis or at all, or there are issues with financial insolvency of our third-party vendors or other unanticipated problems or events, we could lose subscription revenue, which would harm our operating results.

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

If we fail to adequately control fraudulent credit card transactions, we may face civil liability, diminished public perception of our security measures and significantly higher credit card-related costs, each of which could adversely affect our business, financial condition and results of operations. If we are unable to maintain our chargeback rate or refund rates at acceptable levels, credit card and debit card companies may increase our transaction fees or terminate their relationships with us. Any increases in our credit card and debit card fees could adversely affect our results of operations, particularly if we elect not to raise our rates for our service to offset the increase. The termination of our ability to process payments on any major credit or debit card would significantly impair our ability to operate our business.

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Item 6. Exhibits

Exhibit No.	Exhibit Description	Incorporated by Reference					Filed Herewith
		Form	File No.	Exhibit	Filing Date	Filed By	
10.26†	2014 Employee Stock Purchase Plan	S-8	333-193612	99.2	January 28, 2014		

31.01	Certification of the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act	X
31.02	Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act	X
32.01	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act	X
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Balance Sheets as of June 30, 2014 and December 31, 2013, (ii) Condensed Statements of Operations for the Three and Six months ended June 30, 2014 and 2013, (iii) Condensed Statements of Comprehensive Loss for the Three and Six months Ended June 30, 2014 and 2013, (iv) Condensed Statements of Cash Flows for the Six months ended June 30, 2014 and 2013 and (v) Notes to Condensed Financial Statements	X

† Indicates management contract or compensatory plan.

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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 29, 2014

By: /s/ Michael S. Herring
Michael S. Herring
Executive Vice President and Chief
Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting
Officer)

**Certification of Principal Executive Officer
Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

I, Brian McAndrews, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pandora Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

July 29, 2014

/s/ Brian McAndrews

Name: Brian McAndrews

Title: Chief Executive Officer, President and Chairman of the Board
(Principal Executive Officer)

**Certification of Principal Financial Officer
Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

I, Michael S. Herring, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pandora Media, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

July 29, 2014

/s/ Michael S. Herring

Name: Michael S. Herring

Title: *Executive Vice President and Chief Financial Officer (Principal Financial Officer)*

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF SARBANES-OXLEY ACT OF 2002**

The certification set forth below is being submitted in connection with this Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (the "Report") for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Each of the undersigned certifies that, to his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Pandora Media, Inc.

July 29, 2014

/s/ Brian McAndrews

Name: Brian McAndrews

Title: *Chief Executive Officer, President and Chairman of the Board
(Principal Executive Officer)*

/s/ Michael S. Herring

Name: Michael S. Herring

Title: *Executive Vice President and Chief Financial Officer (Principal
Financial Officer)*

This certification accompanying the Report is not deemed filed with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities such Section, and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before, on or after the date of the Report), irrespective of any general incorporation language contained in such filing.



Pandora Gains Access to \$14 Billion Radio Ad-Sales Market

By Andy Fixmer - Mar 5, 2013

[Pandora Media Inc. \(P\)](#), the music-streaming service, will compete directly with [radio stations](#) for the first time on the industry's biggest advertising services, gaining better access to the \$14 billion annual ad-sales market.

By May, advertisers will be able to compare Pandora's audience ratings alongside those of radio stations through services that account for 80 percent of local ad sales, Chief Executive Officer [Joe Kennedy](#) said in an interview.

The change eliminates a hurdle for ad buyers and Pandora, which is opening sales offices in the 25 biggest U.S. media markets, Kennedy said. Buyers previously had to manually research Pandora ratings. While early adopters made the effort, the change simplifies the process and will expose Pandora to a larger group of marketers, he said.

"Pandora will now be there side by side, apples to apples, in the same systems used every day to purchase radio advertising," Kennedy said. "We get terrific visibility on these systems."

Strata Marketing Inc. began including Pandora ratings on its network in January, Kennedy said. Mediaocean is in testing and plans to add Pandora ratings by the end of April. Chicago-based Strata, with about 1,000 ad agencies, and New York-based Mediaocean have nearly equal market share, he said.

Pandora, based in Oakland, [California](#), fell 2.4 percent to \$12 yesterday in [New York](#). The [stock](#) has climbed 31 percent this year.

Investors will get their first peek at how ad sales fared on Strata on March 7, when Pandora reports results for the quarter ended Jan. 31. Excluding some items, analysts [forecast](#) a loss of 6 cents a share, the average of 20 estimates compiled by Bloomberg, on revenue of \$122.6 million.

Pandora drew 65.6 million listeners and commanded an 8 percent share of the U.S. radio audience in January.

The company's costs to stream music are rising faster than its ad sales. Music expenses jumped 81 percent in nine months ended Oct. 31, while ad sales gained 59 percent. Starting this month, the

company capped mobile listening at 40 hours a month to contain costs.

To contact the reporter on this story: Andy Fixmer in [Los Angeles](#) at afixmer@bloomberg.net

To contact the editor responsible for this story: Anthony Palazzo at apalazzo@bloomberg.net

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PANDORA[®]

Investor Presentation

Q2 CY2014

Safe Harbor

These slides and the accompanying oral presentation contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts contained in these slides and the accompanying oral presentation, including statements regarding Pandora Media's ("Pandora" or the "Company") future operations, future financial position, future revenue, projected expenses, opportunities, prospects, plans and objectives of management and competitive and technological trends are forward-looking statements. In some cases, you can identify forward-looking statements by terms such as "anticipate," "believe," "estimate," "expect," "intent," "may," "might," "plan," "project," "will," "would," "should," "could," "can," "predict," "potential," "continue," "objective," or the negative of these terms or similar expressions. The Company has based these forward-looking statements largely on its estimates of its financial results and its current expectations and projections about future events and financial trends that it believes may affect its financial condition, results of operations, business strategy, short term and long-term business operations and objectives and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including, but not limited to, our operation in an emerging market and our relatively new and evolving business model, our ability to evaluate our current and future prospects, our ability to generate additional revenue on a cost-effective basis, our ability to attract and retain advertisers, our ability to increase our listener base and listener hours, competitive factors, our ability to establish and maintain relationships with makers of mobile devices, consumer electronic products and automobiles, our ability to continue operating under existing laws and licensing regimes and a number of other factors outside of our control. These risks and uncertainties may also include those described under the heading "Risk Factors" and elsewhere in the Company's registration statement on Form S-3 on file with the Securities and Exchange Commission (the "SEC") for the offering to which this presentation relates and filings the Company makes from time to time with the SEC. Moreover, the Company operates in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for Company management to predict all risks, nor can the Company assess the impact of all factors on its business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements the Company may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in these slides and the accompanying oral presentation may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Moreover, neither the Company nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. Any forward-looking statement speaks only as of its date. Except as required by law, the Company undertakes no obligation to update publicly any forward-looking statements for any reason after the date of this presentation, to conform these statements to actual results or to changes in the Company's expectations. The Company has filed a registration statement (including a preliminary prospectus) with the SEC for the offering to which this presentation relates. Before you invest, you should read the preliminary prospectus in that registration statement and other documents the Company has filed with the SEC for more complete information about the Company and this offering. You may get these documents for free by visiting EDGAR on the SEC Web site at www.sec.gov. Alternatively, the Company, any underwriter or any dealer participating in the offering will arrange to send you the preliminary prospectus, if you request it by calling toll free 1-866-803-9204.

Dominic Paschel – Vice President

PANDORA®

Redefining Radio for a Connected World

PANDORA®

Radio Consumption

Radio Audience

92% of U.S. Population

240M+ Americans

Music Listening

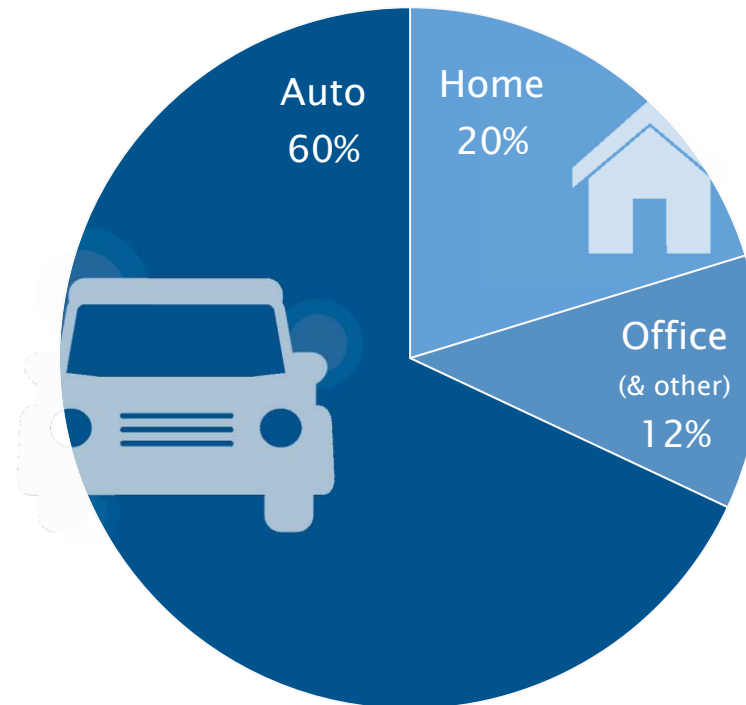
80% Radio

Radio: 18 hours per week

Sources: Weekly percentage of 12+ listeners, number of weekly U.S. radio listeners and Radio listening hours/week (Monday–Sunday 24–Hour Weekly Cume Persons 12+) source is RAB's "Why Radio Fact Sheet" (<http://www.rab.com/public/marketingguide/DataSheet.cfm?id=1>); Music listening as a percentage of radio listening source is VSS Communications Industry Forecasts, 22nd and 24th Editions.

Radio Consumption is Different

Serendipity and Multi-Tasking



Source: Adults 18+. Listening Location: Listen Most during a typical weekday (Percentages will not add to 100% due to duplication among listening locations), RAB
<http://www.rab.com/public/marketingGuide/DataSheet.cfm?id=18>

Redefining Radio for a Connected World

Broadcast Radio

Free
No Effort
Ubiquitous
Discover
New Music



Internet

One to One
Interactive
Personalized

Personalized Radio

An Exciting Point in Pandora's Trajectory



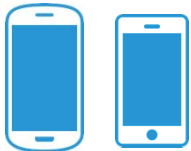
Growth in Active Listeners and Listener Hours



Critical Mass in Local Markets



Integrated into the Broadcast Radio Ad Buying Workflow



Approaching Mobile RPM Inflection Point



Connected Device Integrations



Significant Growth Potential

Reach
Engagement
Monetization

Significant Progress Since the IPO

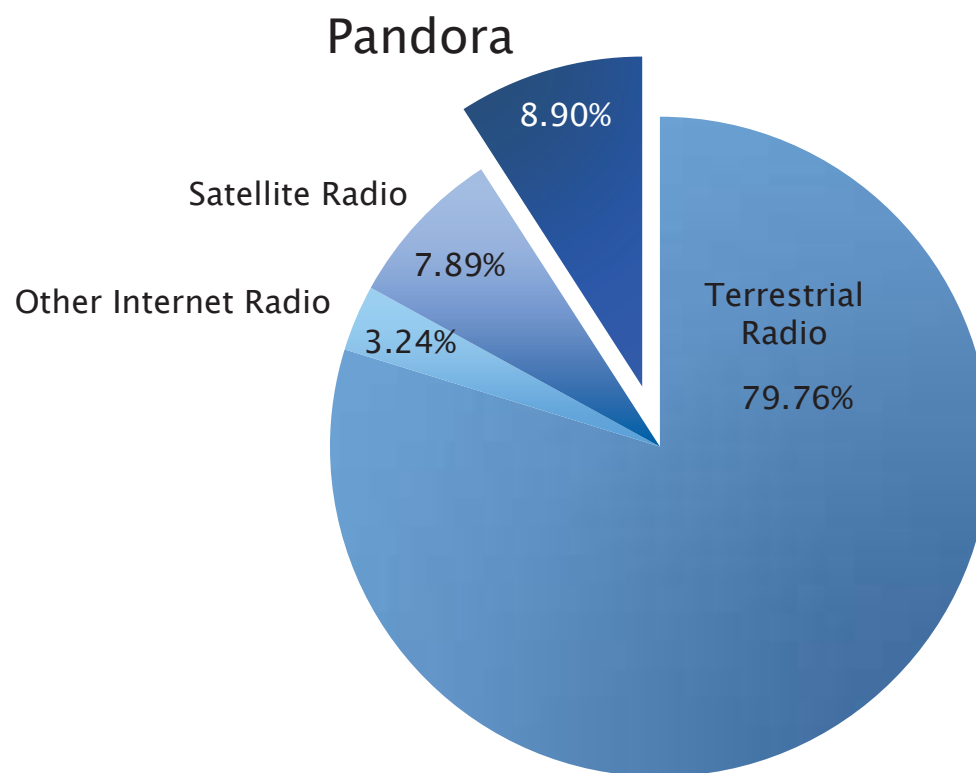
		At IPO	Q2 CY2014	Change
Reach	Registered Users	100M+	250M+	+150%
	Active Users	37M	75M	+103%
Engagement	Thumbs	10BN+	40BN+	+300%
	Quarterly Listener Hours	1.84BN	5.04BN	+174%
	Quarterly Mobile Hours	1.29BN	4.2BN	+226%
	Share of Radio Listening	3.4%	8.9%	+550bps
Monetization	Quarterly Revenue	\$67.0M	\$218.9M	+227%
	Quarterly Mobile Revenue	\$31.9M	\$167.5M	+425%
	Quarterly Mobile RPM	\$24.67	\$39.88	+62%

Note: Registered Users and Thumbs are cumulative data, Active Users and Share of Radio Listening are as of June 2014, remaining data is for full Q2 quarter; Share of Radio Listening from internal company estimates synthesizing Triton Digital, Arbitron and U.S. Census Bureau data for periods indicated. Share of Radio Listening estimate includes satellite. Financial metrics reflect non-GAAP revenue; a reconciliation to GAAP metrics is provided in the Appendix A and E hereto

It is Just the Beginning

All Radio Listening Hours

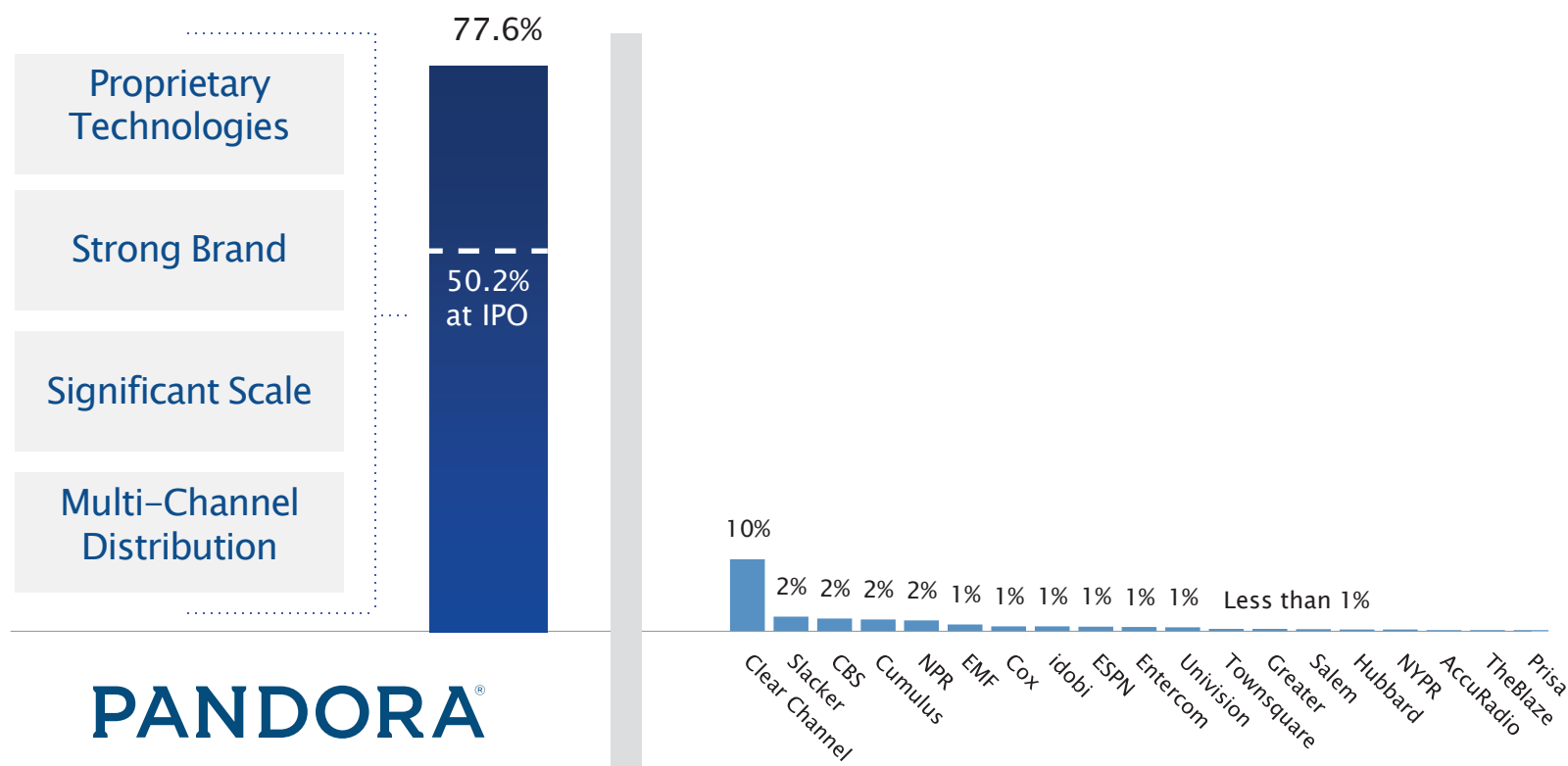
March 2014



Source: Internal company estimates synthesizing Triton Digital, Arbitron and U.S. Census Bureau data for period indicated, June 2014

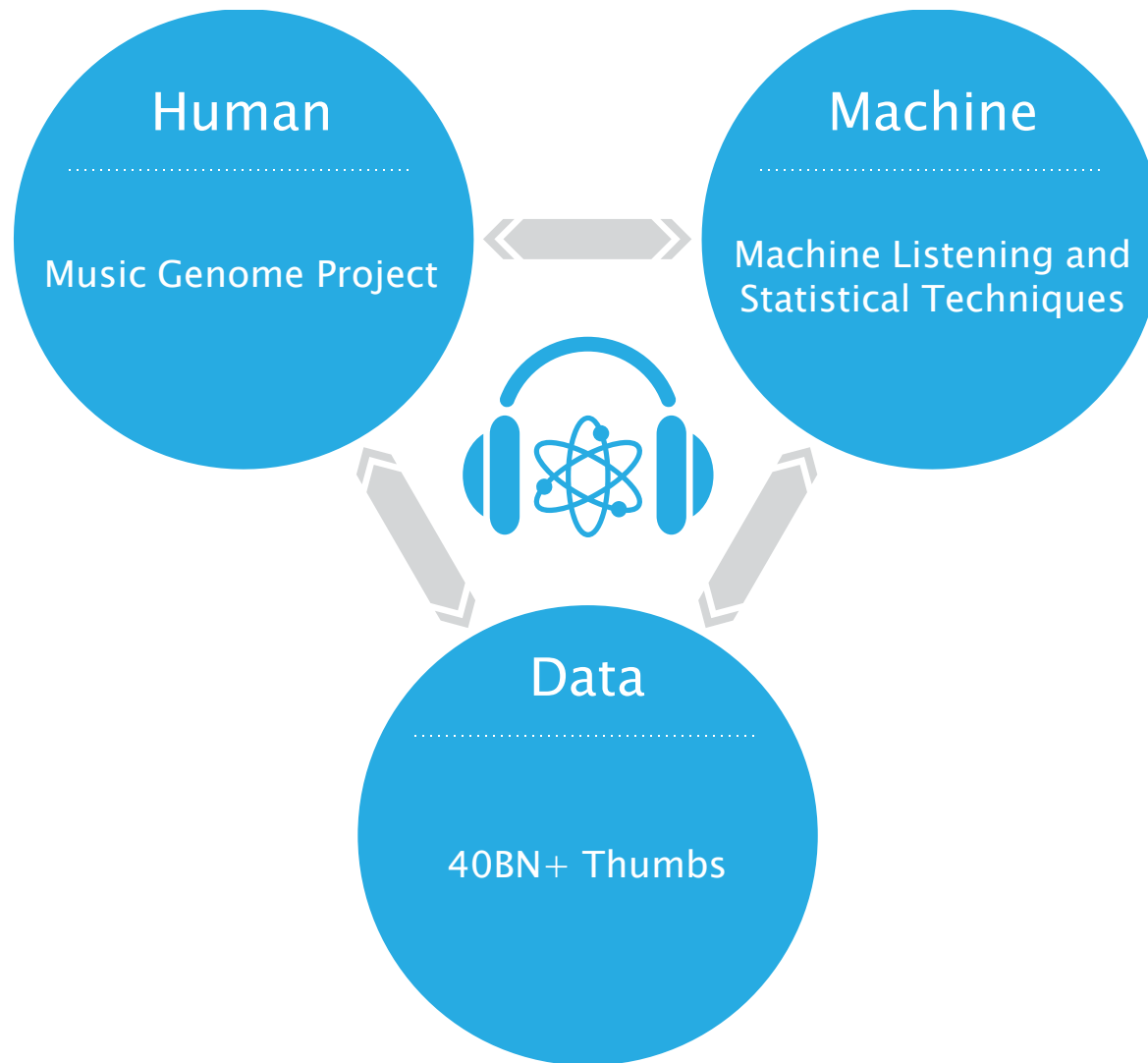
Significant Competitive Strengths

Share of Internet Radio Listening



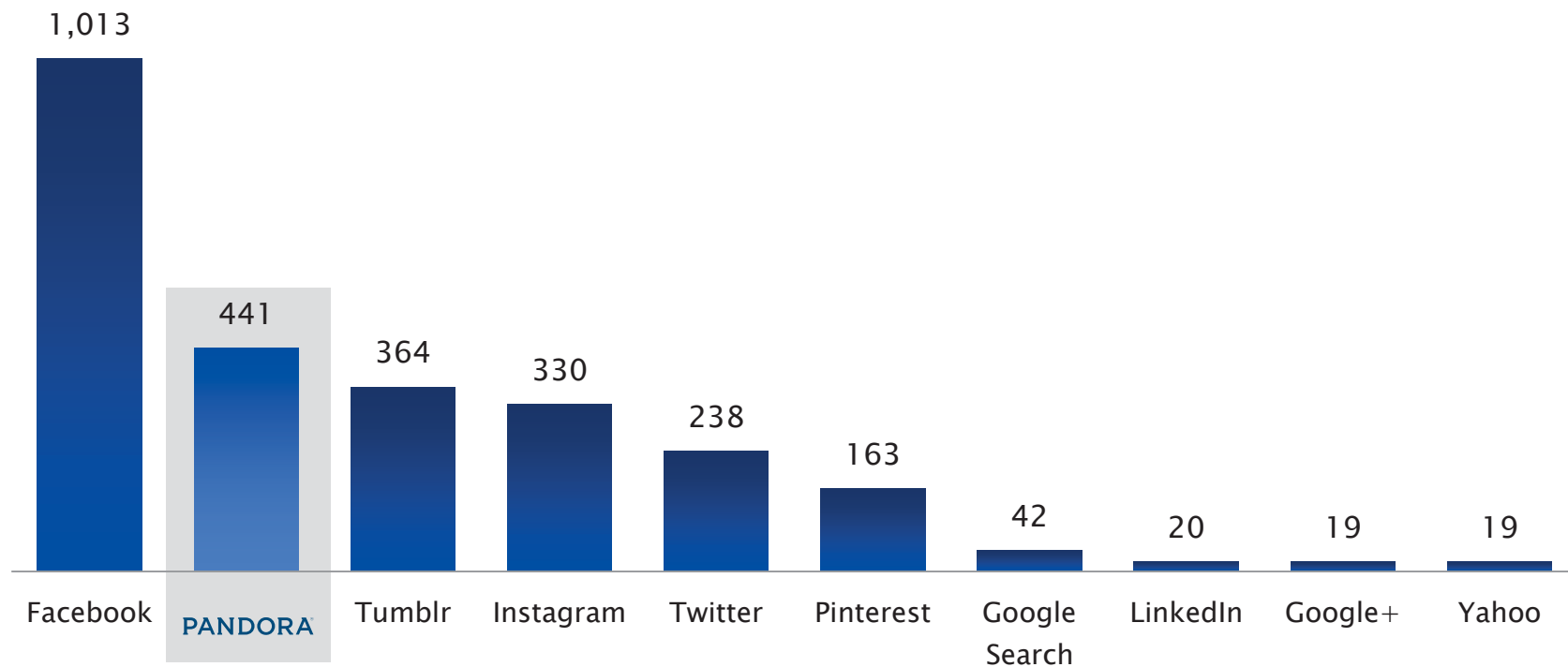
Note: All represent share among the top 20 stations and networks in the U.S., Mon-Sun 6AM-Mid, June 2014
 Source: Triton Digital based on average active sessions

Pioneering Personalization Technologies



Pandora is a Leader in Mobile Engagement

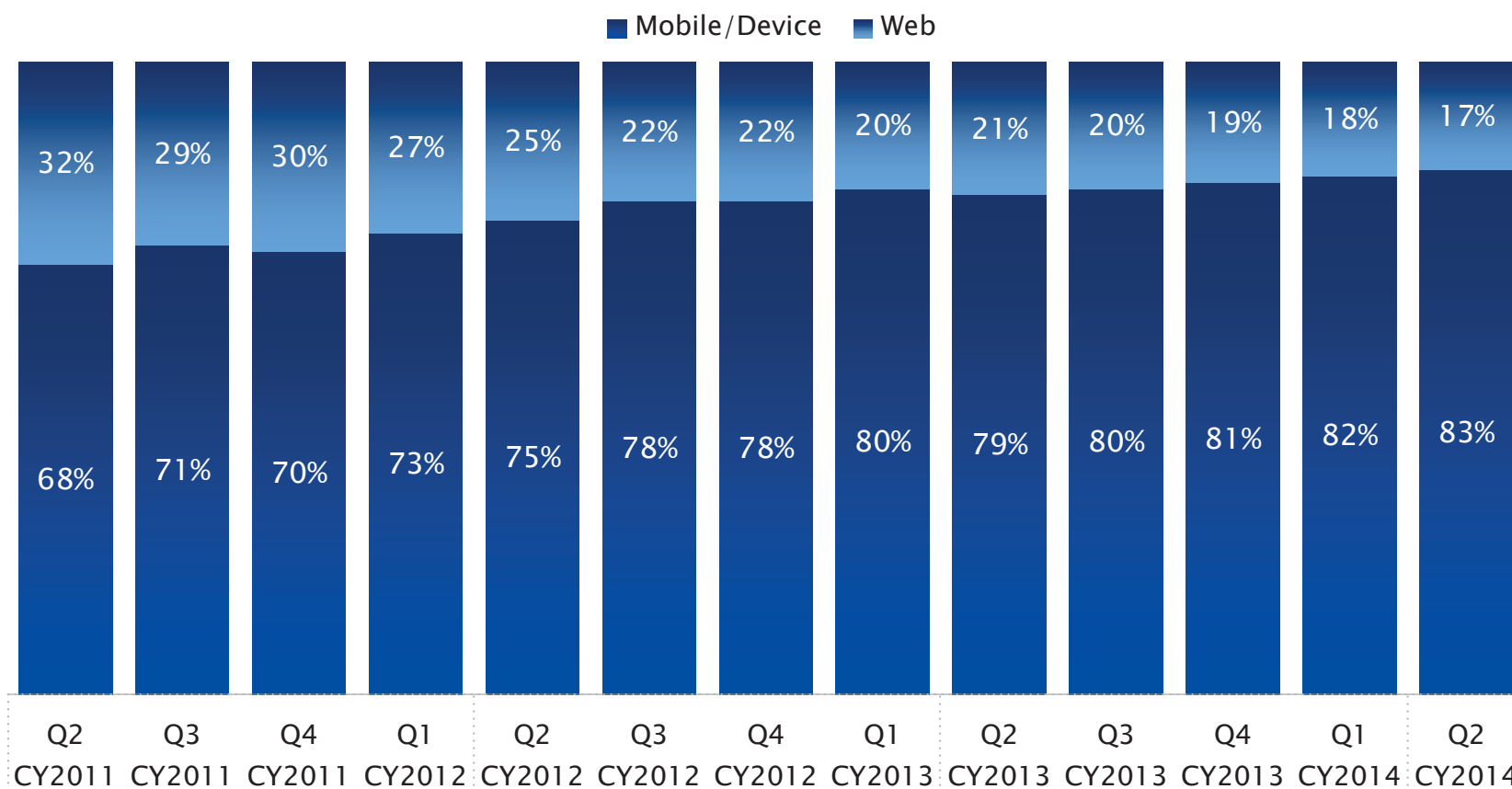
Monthly Mobile App Minutes per Visitor



Source: comScore, December 2013. The data presented does not reflect a comprehensive ranking of all mobile apps

Mobile and Connected Device Listening Dominates

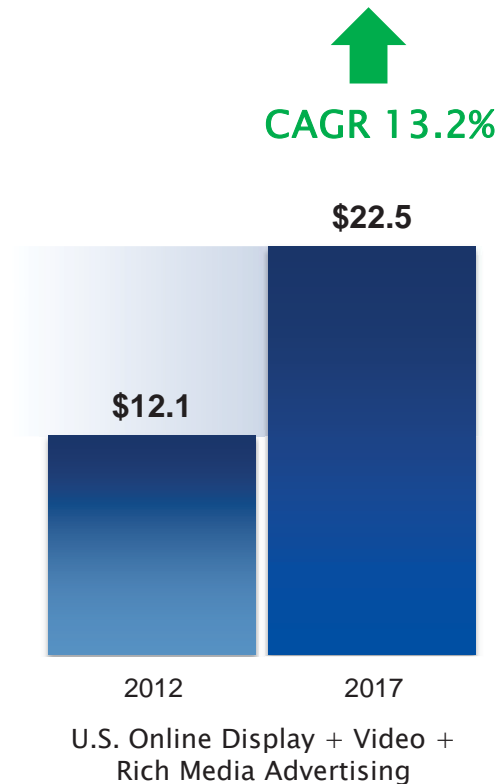
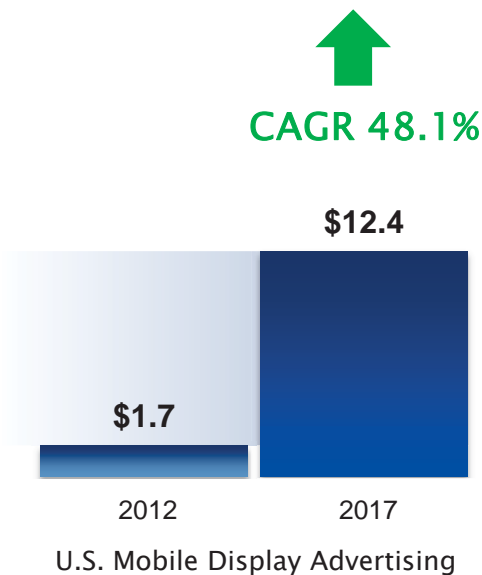
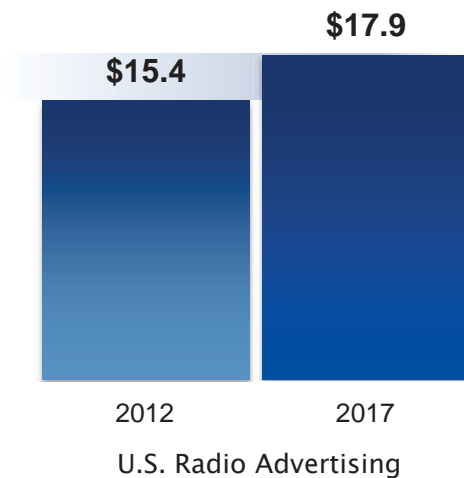
Mobile/Device vs. Web Hours



Source: Internal company data, June 2014

Significant Market Opportunity: 3 Major Ad Markets

74% local



Note: Dollars in billions

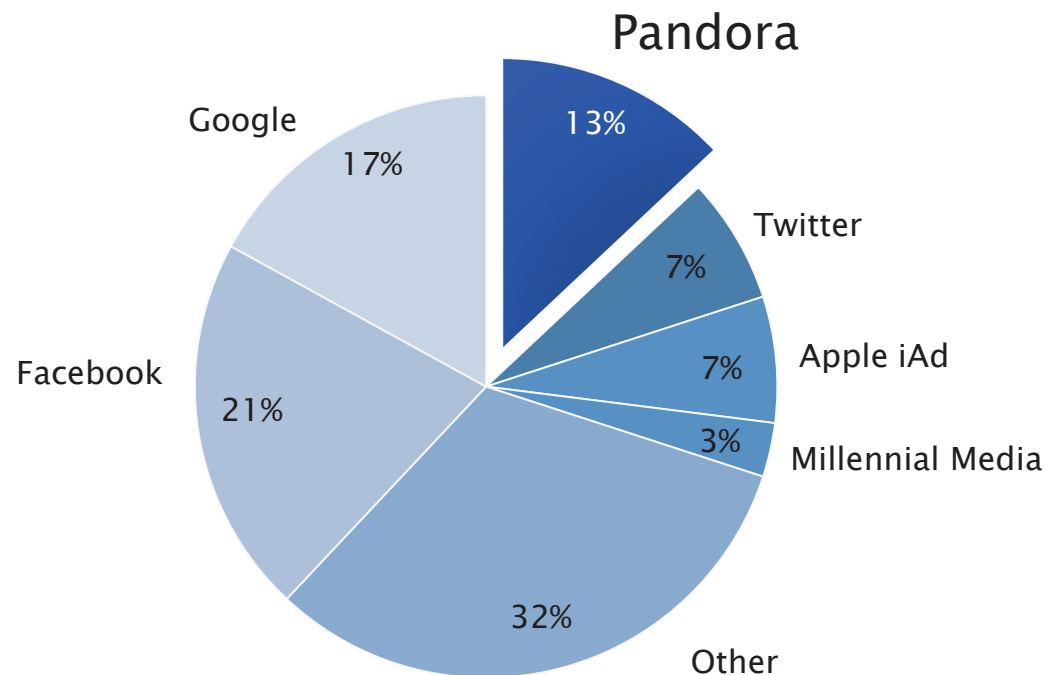
Sources: IDC June 2013, Veronis Suhler Stevenson Communications Industry Forecast 2012 for local market size

3rd Largest Mobile Advertising Company in the U.S.

CY13 mobile ad revenue: \$366.3M

Growth rate Y/Y +69%

2012 U.S. Mobile Display Ad Revenue Share



Note: Net ad revenues after companies pay traffic acquisition costs (TAC) to partner sites; includes display (banners and other, rich media and video); ad spending on tablets is included; excludes SMS, MMS and P2P messaging-based advertising

Source: Company revenue and growth rate from internal company estimates, U.S. mobile display ad revenue share source is eMarketer, June 2013

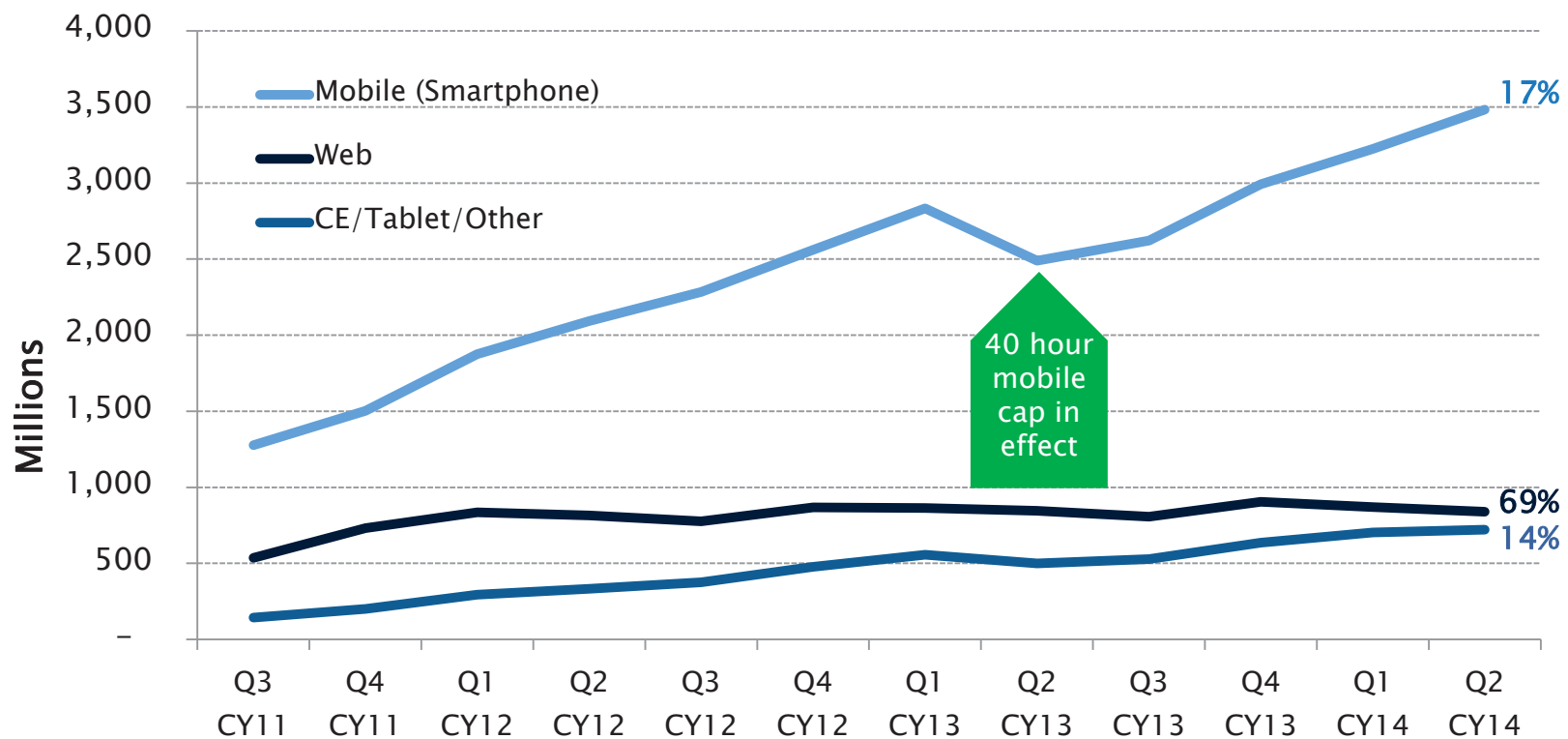
Defining the Frontier of Mobile Connectivity

PANDORA®

Connected Devices Gaining Share

Pandora Listening Hours Across Devices

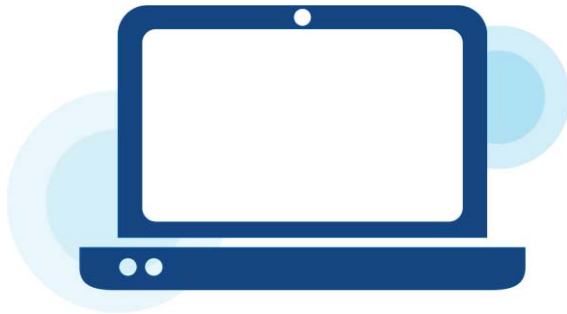
More than 25% of Pandora listeners engage across two or more different devices



Source: Internal company data, June 2014

Pandora Everywhere

Desktop/Laptop



Consumer Home Electronics



Smartphone/Tablet



Auto



Auto Partners

Integration with more than

145

Vehicle models

(1 / 3 of all new U.S. cars in 2013)

270

Automotive
Aftermarket devices



Source: Internal company data, June 2014

Focused on Mobile Monetization

Two Pronged Approach

Digital Strategy: Online + Mobile



Extend Reach
Reach people wherever they listen

Radio Strategy: Audio Everywhere



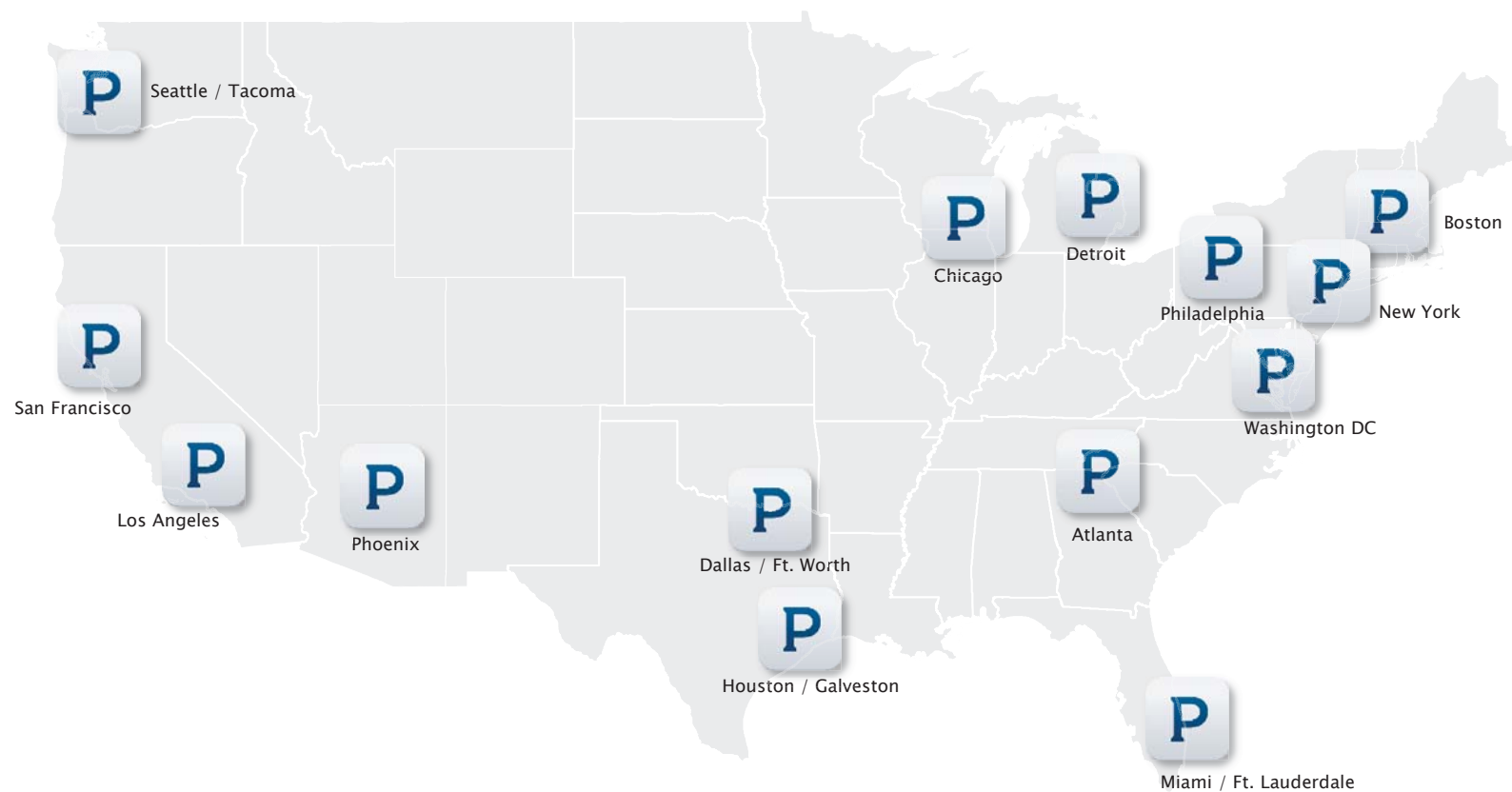
Superior Audio Product
Targetable • Interactive • Measureable

Unlocking Local Audio Advertising

PANDORA®

Pandora is the Equivalent of a Large Station in Most Top Markets

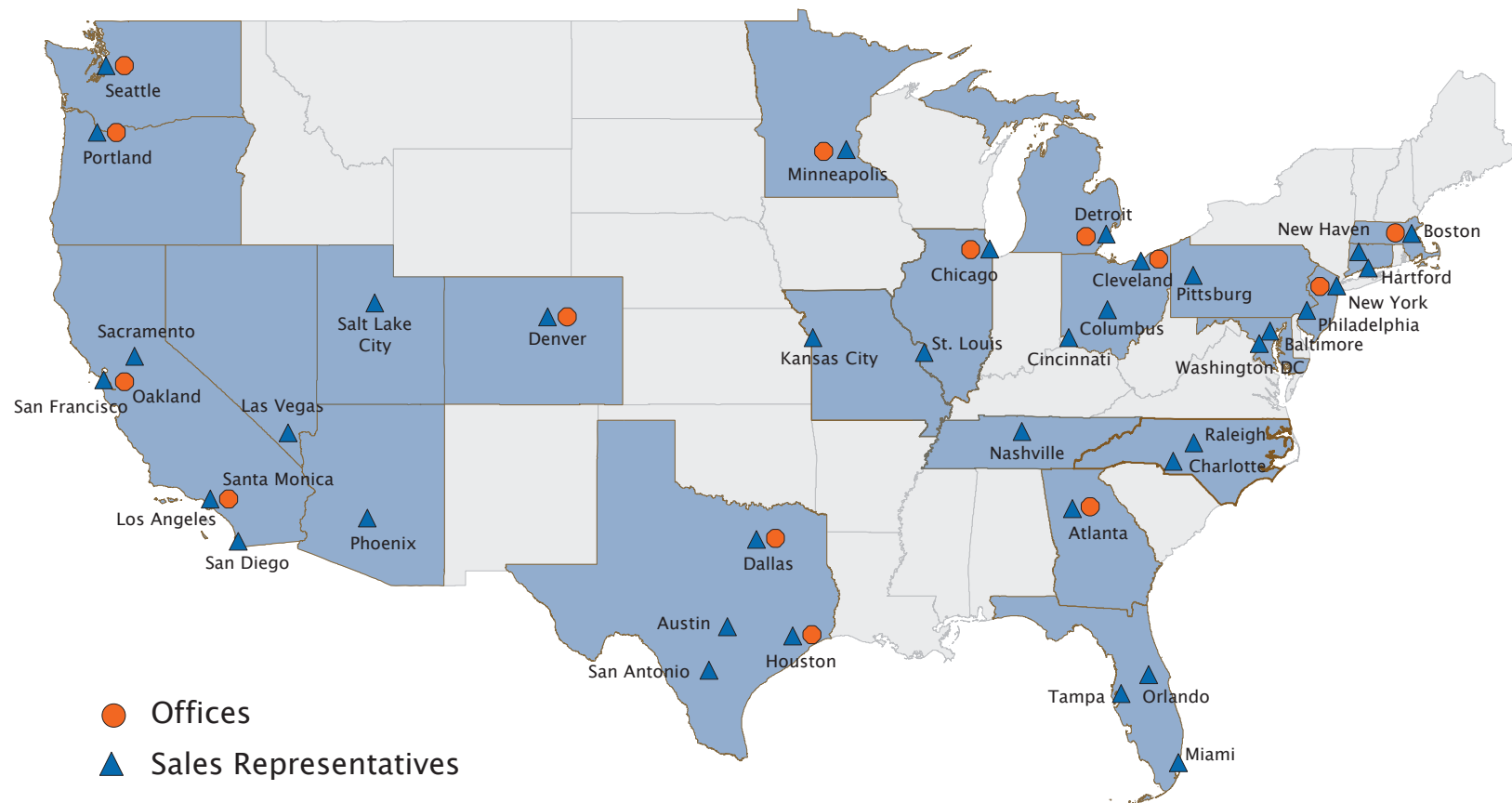
Pandora is the number 1 station in 14 of the top 15 local radio markets



Note: Radio listening in the past week, A18+
Source: The Media Audit, May 2012 – October 2013

Pandora Sales Force Geographic Footprint

Pandora now has a local sales presence in 37 markets



Attacking the Local Opportunity



Blue Chip and Local Advertiser Customer Base

Auto	Food & Beverage	Media/ Telecom	Consumer/ Retail	Technology	Travel/ Hospitality	Local Advertising
						
						
						
						
						
						
						
						
						

 National advertisers with local campaigns

Radio buyers can now compare Pandora audience size with other local radio stations in

276

markets across the country

27

Financials

PANDORA®

Pandora's Business Model

Advertising



Q2CY14 Revenue \$177.3M

Y/Y Growth 39%

% of Total Revenue 81%

Subscription Service

PANDORA
— ONE™ —

Q2CY14 Revenue \$41.6M

Y/Y Growth 63%

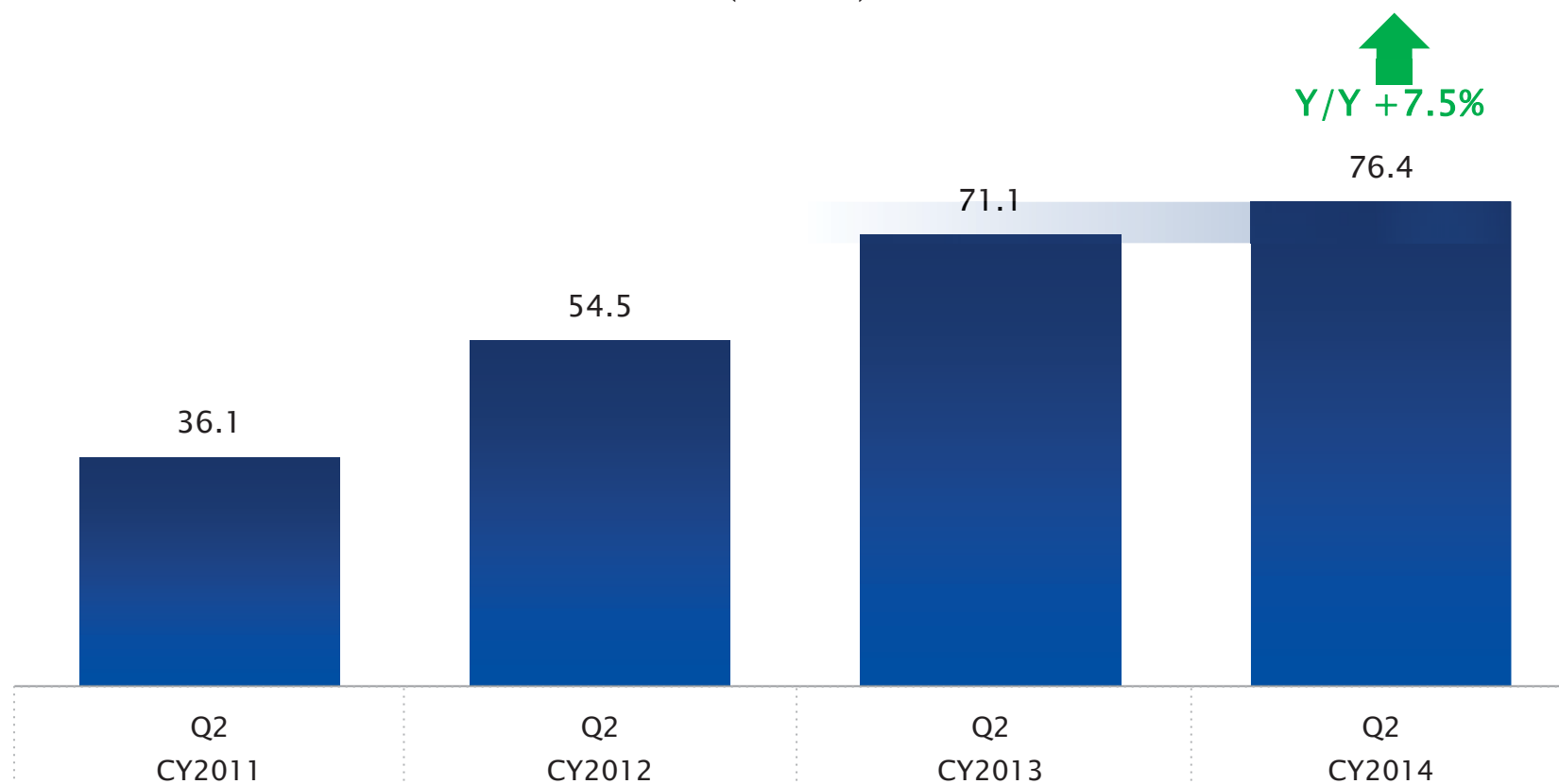
% of Total Revenue 19%

Note: Subscription and other revenue combined; Financial metrics reflect non-GAAP revenue; a reconciliation to GAAP metrics is provided in Appendix B hereto
Source: Internal company data, June 2014

Active User Growth

Active Users

(Millions)

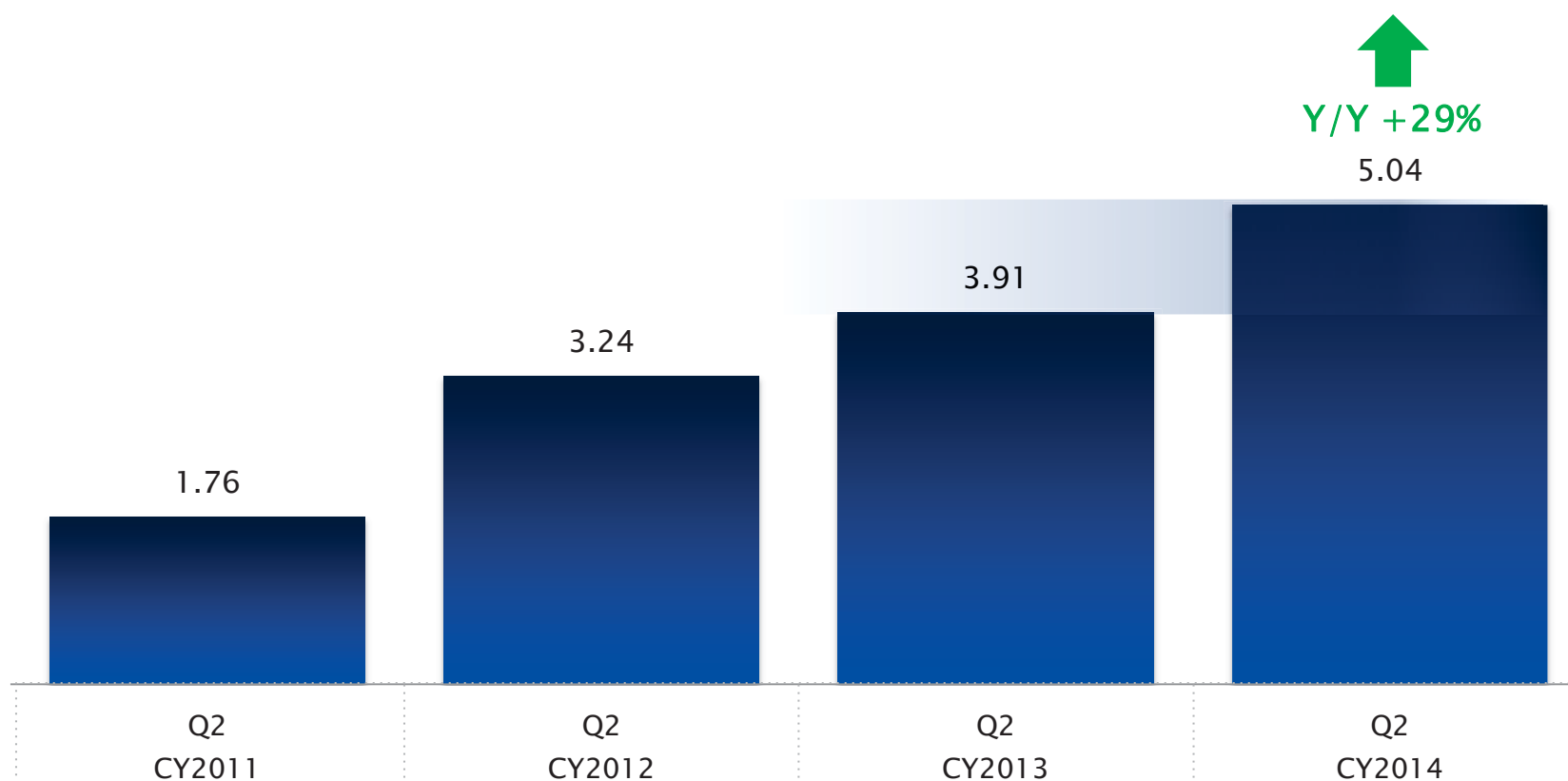


Note: Total active users are defined as the number of distinct registered users that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period
Source: Internal company data, June 2014

Growth in Listener Hours

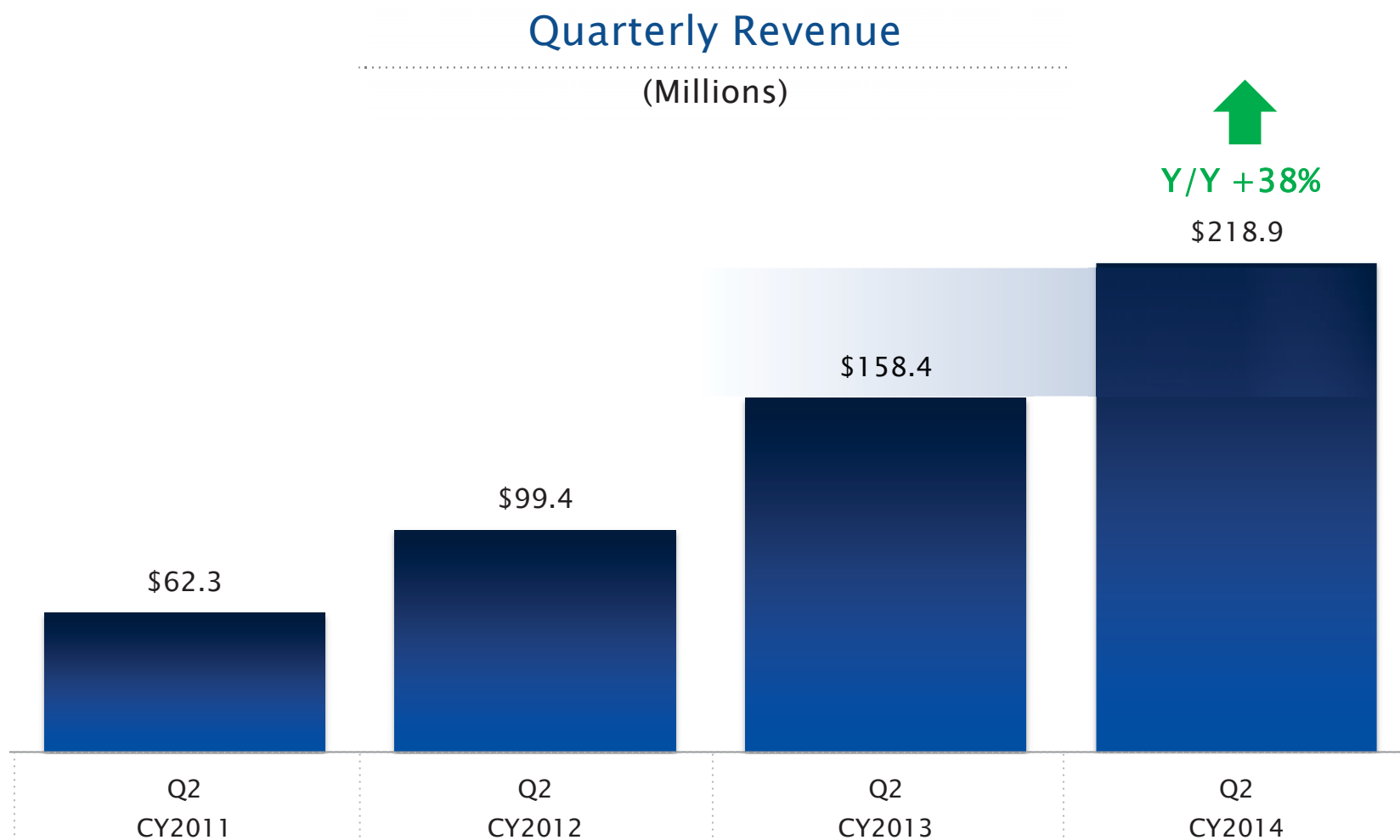
Quarterly Listener Hours

(Billions)



Source: Internal company data, June 2014

Quarterly Revenue Growth

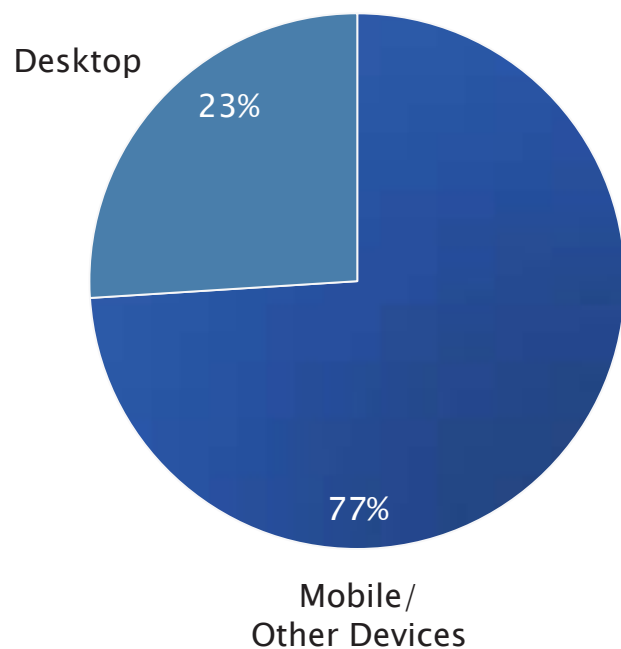


Note: Financial metrics reflect non-GAAP revenue; a reconciliation to GAAP metrics is provided in Appendix A hereto
Source: Internal company data, March 2014

Strong Mobile Revenue Growth

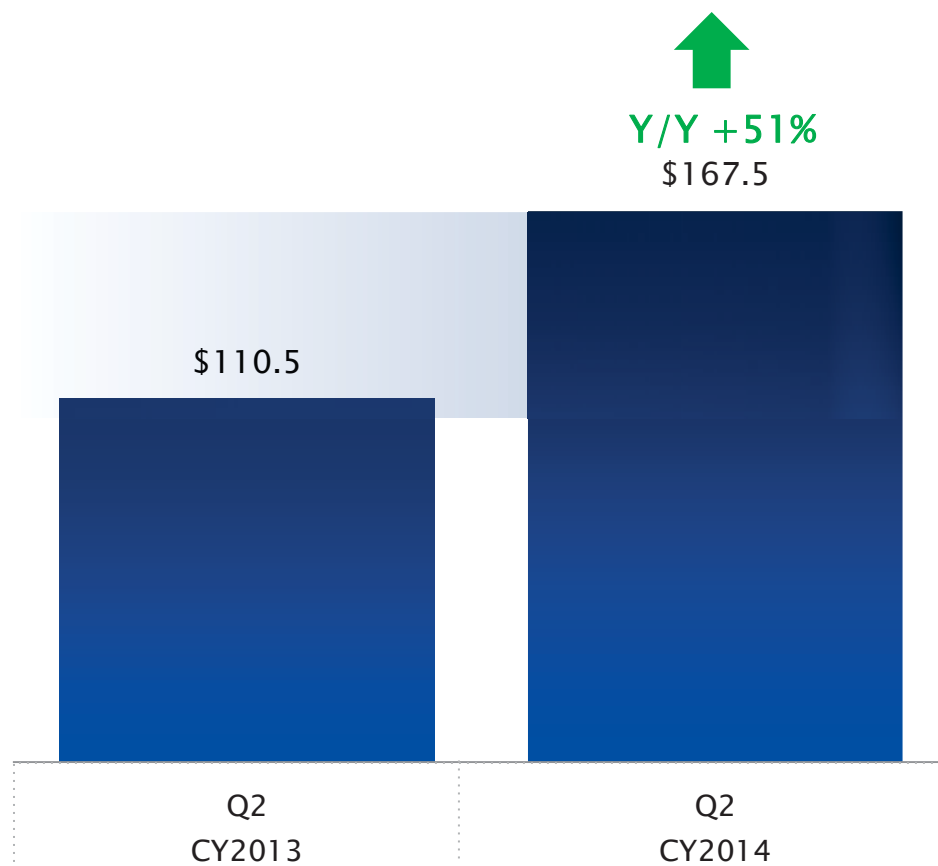
Mobile Revenue Share

(Q2 CY2014)



Quarterly Mobile Revenue

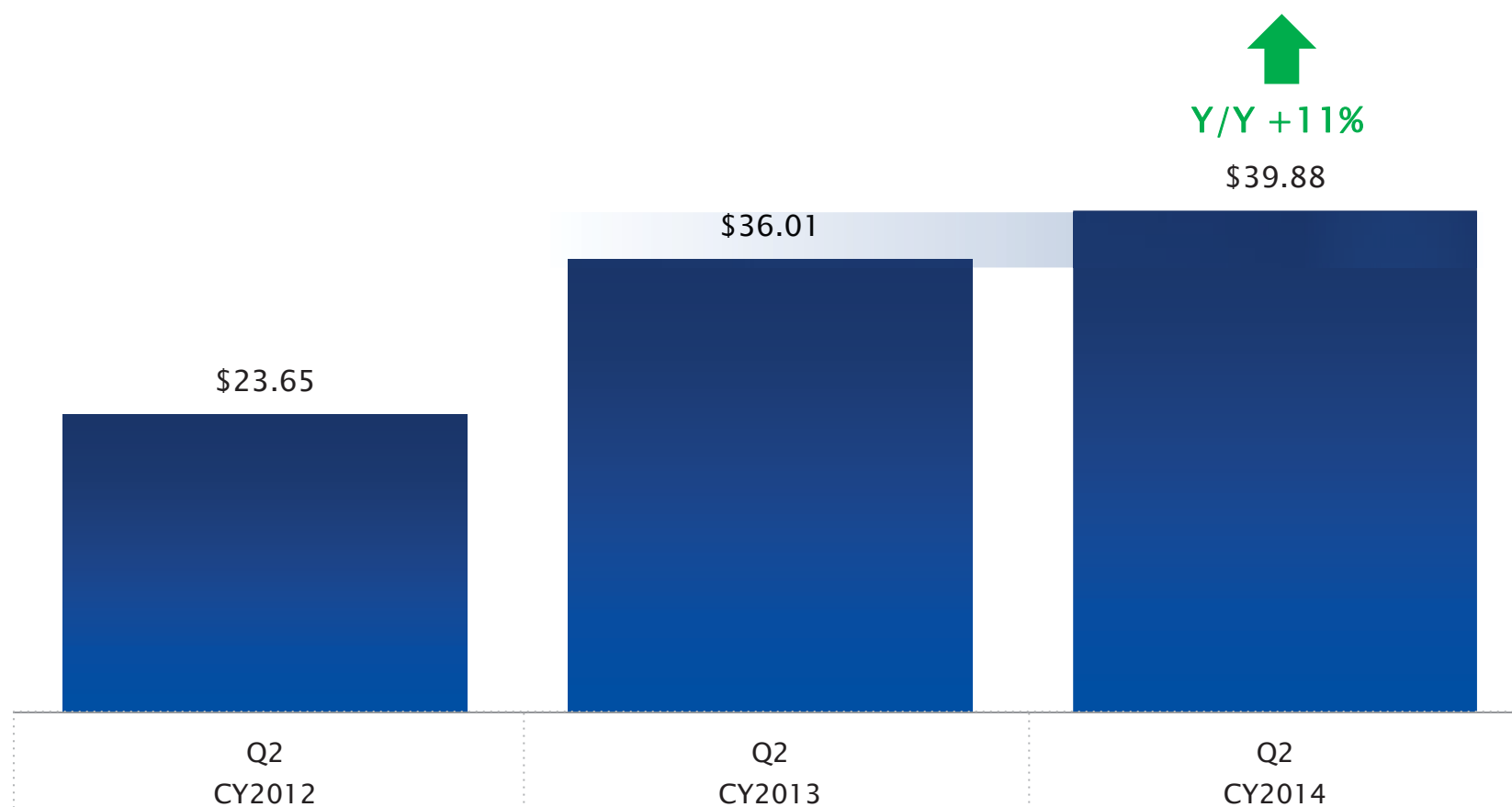
(Millions)



Note: Financial metrics reflect non-GAAP revenue; a reconciliation to GAAP metrics is provided in Appendix A hereto
Source: Internal company data, June 2014

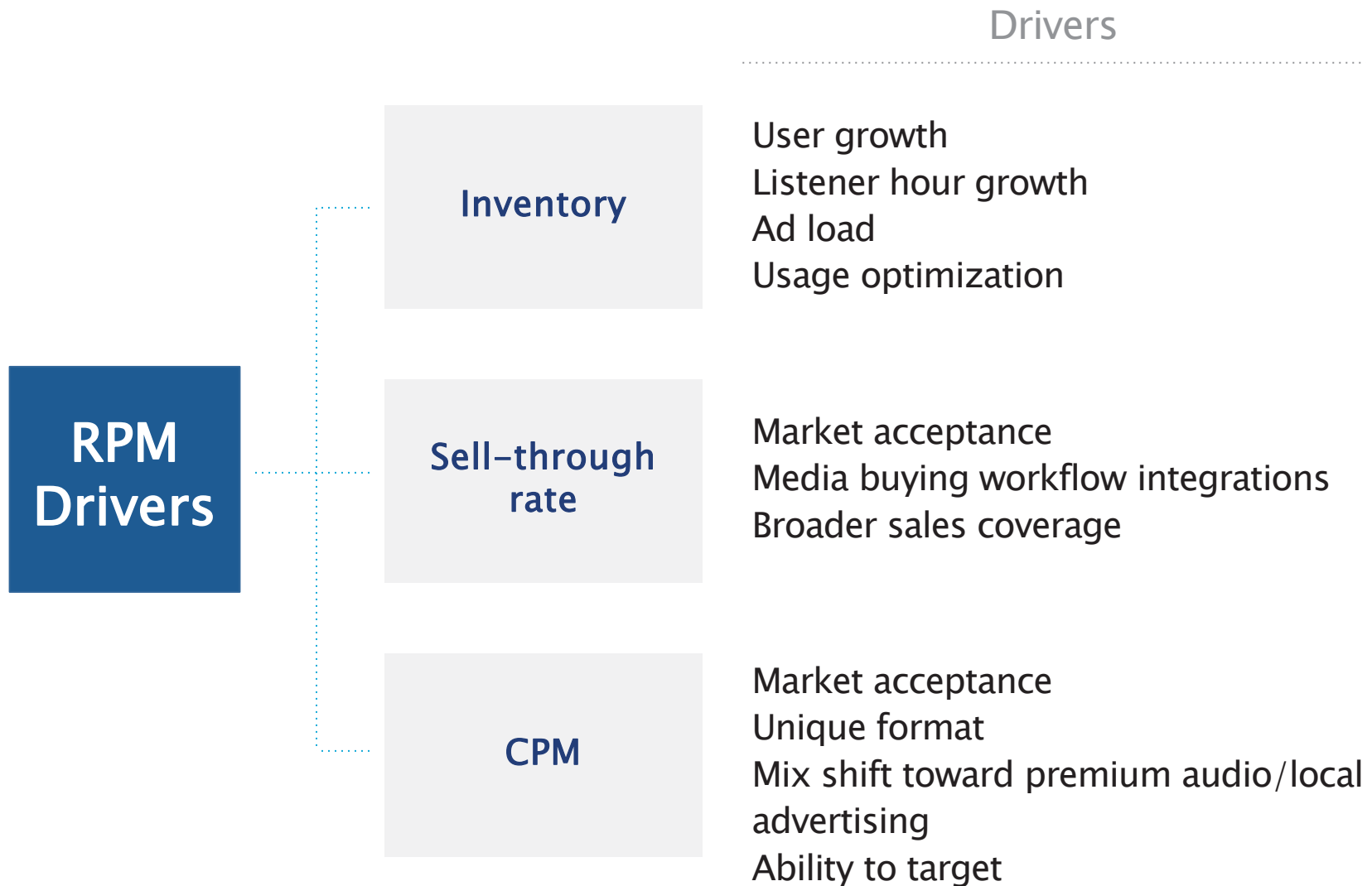
Proven Ability to Increase Mobile Monetization

Mobile RPM Progression



Note: Financial metrics reflect non-GAAP revenue; a reconciliation to GAAP metrics is provided in Appendix E hereto
Source: Internal company data, June 2014

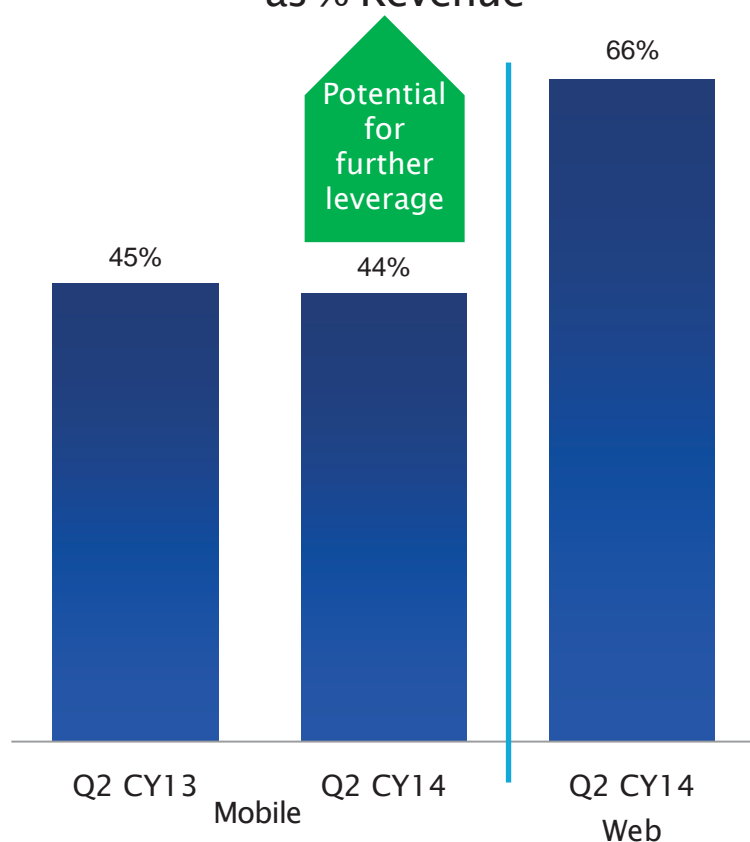
Unpacking RPM: Key Drivers



Expanding Variable Margin Allows for Investment in S&M

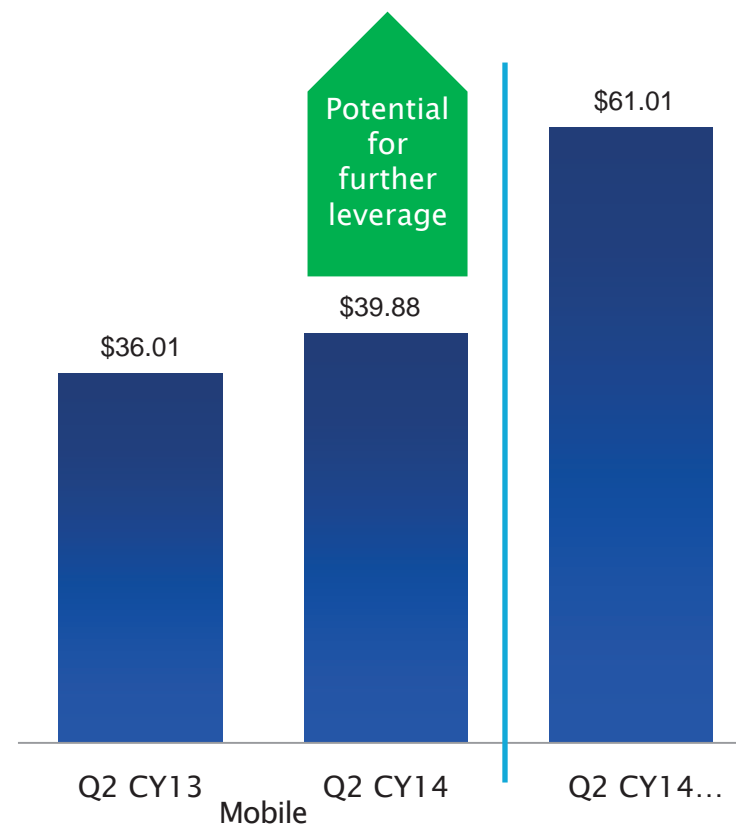
Expanding Gross Margin

Growing Revenue Less Content Costs
as % Revenue¹



Investment in High ROI Growth

Increasing Mobile RPM



¹ Advertising only

Note: RPM financial metrics reflect non-GAAP revenue; a reconciliation to GAAP metrics is provided in Appendix E hereto

Source: Internal company data, June 2014

Royalty and Licensing Agreements

Sound Recording Rights

Statutory License

SoundExchange

SoundExchange arbitration process for future rates expected to begin early 2014

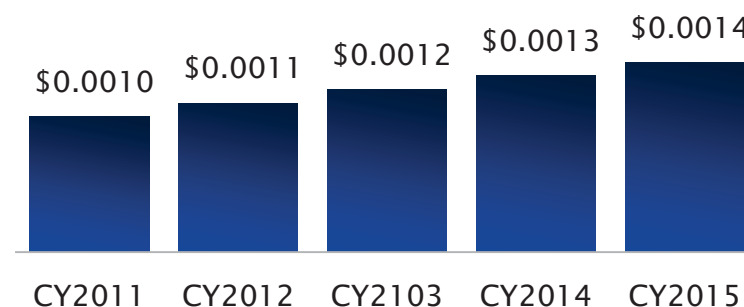
Music Composition Rights

ASCAP, BMI, SESAC

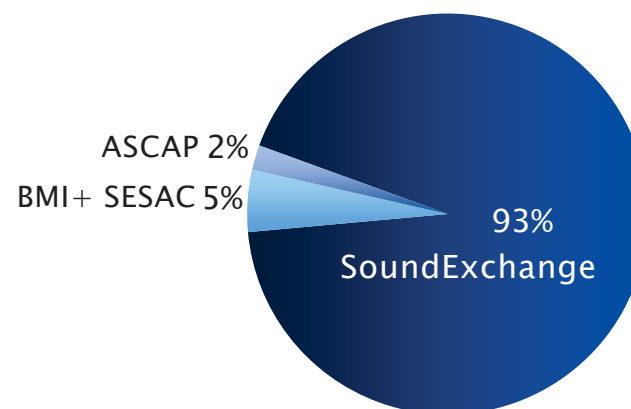
Other Publishers

SoundExchange Agreement

(Licensing Cost per Ad-Supported Track)

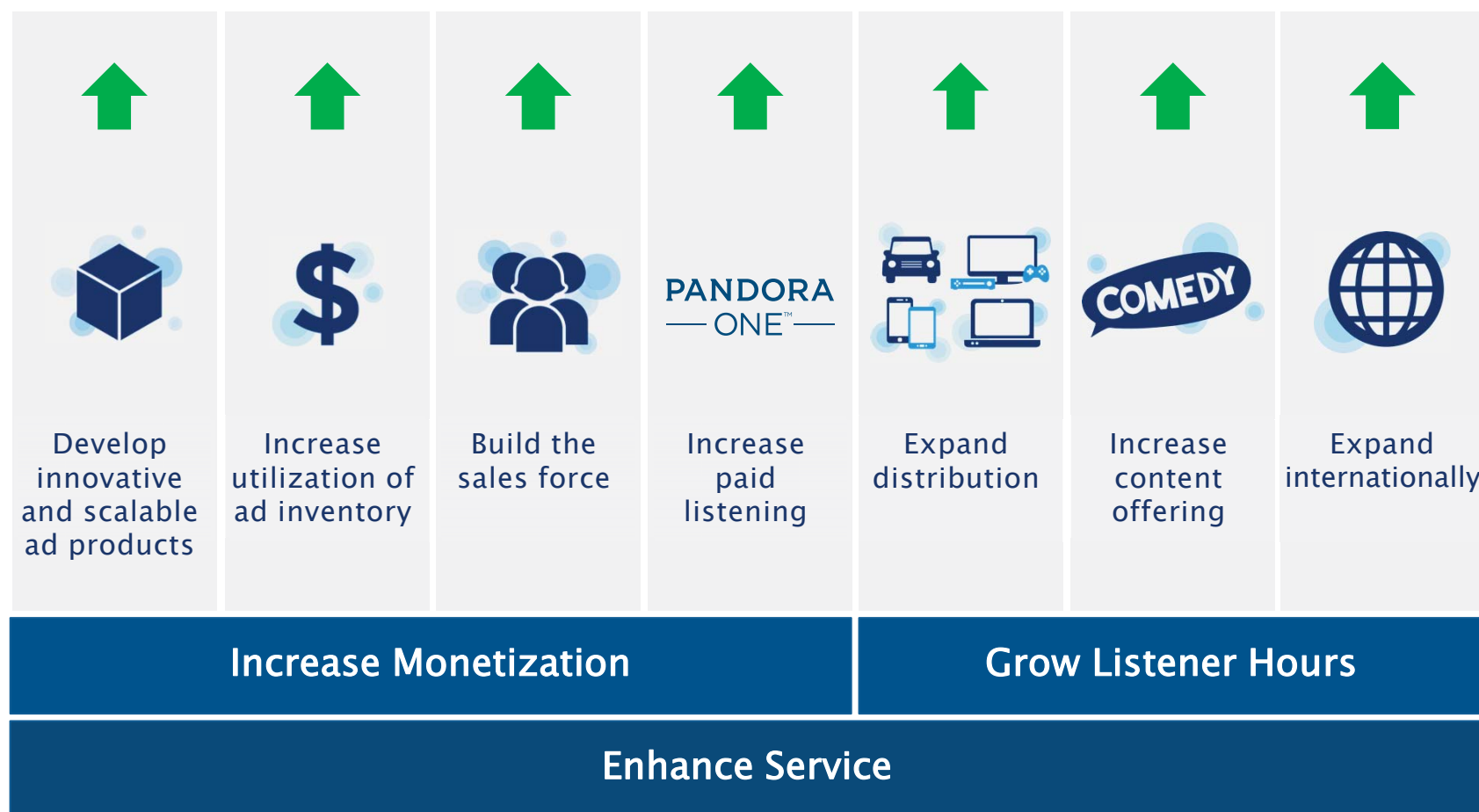


CY2013 Content Acquisition Cost



Source: Company information, January 2014

Significant Long-Term Growth Drivers



Long-Term Business Model

% of Non-GAAP Revenues	Last Year CY2012	Today CY2013	Goal
Content Acquisition Cost	60%	53%	~40%
Cost of Revenue – Other	7%	7%	~7%
Product Development	3%	4%	~7%
Sales and Marketing	22%	25%	~20%
General and Administrative	10%	10%	~6%
Non-GAAP Operating Profit	(1%)	2%	~20%

Note: A reconciliation to GAAP metrics is provided in Appendix A and D hereto
Source: Internal company data, January 2014

The image features the Pandora logo in a white, serif font, centered horizontally. The background is a dark navy blue, decorated with numerous out-of-focus circular light spots in shades of teal, light blue, and white, creating a bokeh effect. The logo itself is a clean, white, serif typeface with a registered trademark symbol (®) at the end.

PANDORA®

Appendix A

Financial Reconciliation – GAAP vs. Non-GAAP

Revenue and Net Income

Prior to FY2012 there were no Non-GAAP Revenue Adjustments

	Three months ended	
	June 30,	
	2013	2014
	(unaudited)	
Revenue		
GAAP total revenue	\$ 153,104	\$ 218,894
Subscription return reserve	5,331	-
Non-GAAP total revenue	<u>\$ 158,435</u>	<u>\$ 218,894</u>
Net income (loss)		
GAAP net loss	\$ (6,902)	\$ (11,728)
Subscription return reserve	5,331	-
Amortization of intangibles	-	182
Stock-based compensation	10,138	20,613
Non-GAAP net income (loss)	<u>\$ 8,567</u>	<u>\$ 9,067</u>

Appendix B

Financial Reconciliation – GAAP vs. Non-GAAP

Revenue

Prior to FY2012 there were no Non-GAAP Revenue Adjustments

	Three months ended June 30,	
	2013	2014
	(unaudited)	
Revenue - GAAP		
Advertising	\$ 127,555	\$ 177,324
Subscription and other	25,549	41,570
Total revenue - GAAP	\$ 153,104	\$ 218,894
Revenue - non-GAAP		
Total revenue - GAAP	\$ 153,104	\$ 218,894
Subscription return reserve	5,331	-
Total revenue - non-GAAP	\$ 158,435	\$ 218,894

Appendix C

Financial Reconciliation – GAAP vs. Non-GAAP

Mobile Revenue

Prior to FY2012 there were no Non-GAAP Revenue Adjustments

	Three months ended June 30,	
	2013	2014
	(unaudited)	
Total revenue by platform		
Traditional computer	\$ 47,588	\$ 51,432
Mobile and other connected devices	105,516	167,462
Total	\$ 153,104	\$ 218,894
Total non-GAAP revenue by platform		
Traditional computer	\$ 47,893	\$ 51,432
Mobile and other connected devices	110,542	167,462
Total	\$ 158,435	\$ 218,894

Appendix D

Financial Reconciliation – GAAP vs. Non-GAAP

Cost and Expenses

Prior to FY2012 there were no Non-GAAP Revenue Adjustments

	Three months ended	
	June 30,	
	2013	2014
Cost of revenue		
Cost of revenue - Content acquisition costs	\$ 79,828	\$ 111,461
Cost of revenue - Other	10,847	13,989
Total cost of revenue - GAAP	90,675	125,450
Less: Stock compensation - Cost of revenue - Other	482	1,032
Total cost of revenue - non-GAAP	\$ 90,193	\$ 124,418
Operating expenses		
Product development	\$ 7,895	\$ 13,076
Sales and marketing	44,371	66,232
General and administrative	16,931	25,865
Total operating expenses - GAAP	69,197	105,173
Less: Stock compensation - Product development	2,394	4,426
Less: Stock compensation - Sales and marketing	5,027	9,922
Less: Stock compensation - General and administrative	2,235	5,233
Less: Amortization of intangibles	-	182
Total operating expenses - non-GAAP	\$ 59,541	\$ 85,410

Appendix E

Financial Reconciliation – GAAP vs. Non-GAAP

RPM

Prior to FY2012 there were no Non-GAAP Revenue Adjustments

	Year ended				Three months ended				Year ended		Three months ended		
	6/30/2012	9/30/2012	12/31/2012	12/31/2012	3/31/2013	6/30/2013	9/30/2013	12/31/2013	12/31/2013		3/31/2014	6/30/2014	
Advertising RPMs													
Traditional computer	\$ 53.99	\$ 57.06	\$ 59.31	\$ 53.47	\$ 44.63	\$ 58.53	\$ 58.44	\$ 61.92	\$ 55.84		\$ 52.75	\$ 62.43	
Mobile and other connected devices	22.25	23.51	25.52	22.15	20.43	32.56	35.31	36.20	30.93		29.46	36.00	
Total	\$ 29.33	\$ 30.30	\$ 32.33	\$ 28.92	\$ 24.85	\$ 37.89	\$ 39.68	\$ 40.95	\$ 35.66		\$ 33.40	\$ 40.11	
Total RPMs													
Traditional computer	\$ 52.07	\$ 55.51	\$ 57.67	\$ 52.01	\$ 45.17	\$ 56.73	\$ 57.50	\$ 61.28	\$ 55.18		\$ 54.42	\$ 61.01	
Mobile and other connected devices	23.25	24.87	26.93	23.38	22.41	34.37	38.75	39.99	33.89		37.43	39.88	
Total	\$ 30.40	\$ 31.70	\$ 33.68	\$ 30.23	\$ 26.96	\$ 39.17	\$ 42.49	\$ 44.14	\$ 38.19		\$ 40.51	\$ 43.41	
Total RPMs based on non-GAAP revenue													
Traditional computer	\$ 52.20	\$ 55.64	\$ 57.83	\$ 52.15	\$ 45.36	\$ 57.09	\$ 57.68	\$ 61.32	\$ 55.37		\$ 52.92	\$ 61.01	
Mobile and other connected devices	23.65	25.20	27.34	23.76	22.92	36.01	39.32	40.10	34.57		34.15	39.88	
Total	\$ 30.74	\$ 31.98	\$ 34.03	\$ 30.55	\$ 27.41	\$ 40.53	\$ 42.98	\$ 44.23	\$ 38.77		\$ 37.55	\$ 43.41	

	Year ended				Three months ended				Year ended		Three months ended		
	6/30/2012	9/30/2012	12/31/2012	12/31/2012	3/31/2013	6/30/2013	9/30/2013	12/31/2013	12/31/2013		3/31/2014	6/30/2014	
Total revenue by platform													
Traditional computer	\$ 41,756	\$ 42,460	\$ 49,415	\$ 168,821	\$ 38,566	\$ 47,588	\$ 45,676	\$ 54,220	\$ 186,050		\$ 47,323	\$ 51,432	
Mobile and other connected devices	56,535	66,347	82,084	241,188	76,558	105,516	123,627	146,142	451,843		146,992	167,462	
Total	\$ 98,291	\$ 108,807	\$ 131,499	\$ 410,009	\$ 115,124	\$ 153,104	\$ 169,303	\$ 200,362	\$ 637,893		\$ 194,315	\$ 218,894	
Total non-GAAP revenue by platform													
Traditional computer	\$ 41,862	\$ 42,553	\$ 49,551	\$ 169,255	\$ 38,731	\$ 47,893	\$ 45,820	\$ 54,256	\$ 186,700		\$ 46,018	\$ 51,432	
Mobile and other connected devices	57,507	67,233	83,326	245,112	78,310	110,542	125,433	146,533	460,818		134,111	167,462	
Total	\$ 99,369	\$ 109,786	\$ 132,877	\$ 414,367	\$ 117,041	\$ 158,435	\$ 171,253	\$ 200,789	\$ 647,518		\$ 180,129	\$ 218,894	

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Advertisement

ADVERTISING

Pandora Courts Local Advertisers, by Offering Well-Defined Listeners



Aaron Houston for The New York Times

William Feinstein of Planet Honda says iPhone traffic to his site quadrupled after he advertised on Pandora.

By BEN SISARIO and TANZINA VEGA
Published: April 15, 2012

The music was pumping and the finger food laid out in abundance one recent evening in a subterranean Manhattan bar, as executives of [Pandora Media](#), the Internet radio service, mingled with some of their most prized new advertisers.

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[News From the Advertising Industry](#) (April 16, 2012)

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Alex Wong/Getty Images

Most of the clients, however, were not representing big corporate accounts or multimillion-dollar national campaigns, but rather local businesses whose budget might top off at \$20,000 a month. Yet they are the focus of one of Pandora's most important new corporate strategies as it competes with terrestrial broadcasters for a chunk of radio's \$17 billion ad market.

Pandora's pitch to advertisers is that its technology can cater to consumers with far greater precision than radio — it can pinpoint listeners by age and sex, ZIP code or even musical taste — and that as it grows, Pandora will effectively be the top station in many cities.

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Tim Westergren

“A dollar spent on Pandora is better than a dollar spent on terrestrial radio,” said Tim Westergren, the company’s founder and chief strategy officer, nearly shouting at a corner table to be heard above the din of his party.

Competing head-to-head with terrestrial radio’s armies of local sales staff members will not be easy. But for Pandora, increasing ad revenue is essential.

The service went online in 2005, streaming free music tailored to listeners’ tastes, and its growth has been explosive. In the last two years, it has gone from 45 million to 125 million registered users, and its revenue has increased from \$55 million to \$274 million, the vast majority of it from advertising (it also sells ad-free access for \$36 a year). In March, Pandora streamed a billion hours of music.

But the company has never turned an annual profit, and its stock has taken a beating. It began trading last June at \$16 a share, and recently hit a record low of \$8.54. The array of analysts’ target prices — from \$3.75 to \$18 over just the last month — suggests that Wall Street does not know quite what to make of Pandora.

The company’s costs are a concern. Under the terms of its music licenses, it must pay more in royalties with each new user; last year it paid out \$149 million, or 54 percent of its revenue — a far higher percentage than broadcasters pay.

The path to profitability, as Pandora’s executives and some of its champions on Wall Street see it, is through car dealerships and mattress shops.

“Local advertising dollars are the key component of Pandora’s future success,” said Jordan Rohan, an analyst at Stifel Nicolaus. “And the company has amassed enough of an audience that it can no longer be overlooked by radio advertising dollars.”

This year, Pandora has had 400 local advertising campaigns across the country. One new client was Planet Honda in Union, N.J., whose president, William Feinstein, said he gave up on terrestrial radio years ago because he felt it cast too wide and expensive a demographic net.

But attracted by Pandora’s ZIP-code targeting, he spent \$10,000 to advertise on the service in January. iPhone traffic to his Web site — which he attributes to the ads — more than quadrupled, Mr. Feinstein said, and so he increased his spending to \$15,000, then \$20,000.

“A light bulb went off,” he said at Pandora’s party, holding a glass of wine. “We don’t need to buy five radio stations. We can buy one.”

Pandora believes the targetability of its ads will lead local businesses to see it as an attractive alternative to terrestrial radio. “This is really powerful information, and ensures that you don’t waste your money in the wrong area,” said Heidi Browning, the company’s senior vice president for strategic solutions.

The same goes for the amount of audio advertising it subjects listeners to. While ads on terrestrial radio come in blocks of as long as five or six minutes at a time, Pandora’s spots, at 15 to 30 seconds, run only once every 20 minutes, Ms. Browning said. Users encounter ads only if they are engaged with the site, which could mean clicking a “thumbs up” or “thumbs down” to a song or changing a station.

(That has not stopped listeners from taking to Twitter to complain that Pandora’s ads are intrusive, nor some analysts from saying that using the service is too passive an activity for the spots to have much effect.)

In addition to audio segments, Pandora’s ad menu includes Web banner ads, which can include video; “skins” that allow an advertiser to essentially wallpaper the site; stand-alone video ads; and branded music channels. To promote engagement, audio segments can be accompanied by clickable display ads offering coupons or product information.

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One potentially big category for Pandora this year, particularly when it comes to local markets, is political advertising. Like the car dealerships, campaigns can zero in on voters by age, ZIP code or Congressional district. (Or, just in case a race turns musical, by genre.)

By trying to take ad dollars away from broadcasters, Pandora is competing over a pot of money that is expected to barely budge in coming years, and the broadcasters are doing everything they can to hold on to it.

According to the research firm eMarketer, ad revenue for online radio is expected to soar 67 percent, from \$900 million this year to \$1.5 billion in 2016. But over the same period, over-the-air radio's take will advance only around 4 percent, to \$16.5 billion. Agency executives say that terrestrial and online radio ads are increasingly being counted as part of the same "audio" category, which implies a zero-sum game.

"At the end of the day, the client budget isn't growing; in some cases it's shrinking," said Dave Marsey, a senior vice president at Digitas, part of the Publicis Groupe. "You're seeing dollars move from out of terrestrial and into more accountable, targetable channels."

The big broadcasters, like Clear Channel and CBS Radio, say they do not see Pandora as a significant competitor. While Pandora portrays itself as a new form of radio, the broadcasters argue that Pandora is a different form of media entirely. One important distinction, they say, especially when it comes to local ads, is that Pandora cannot offer the local content — news, traffic, weather, talk — that for many listeners (and advertisers) defines what radio is all about.

"Pandora is not a threat to radio, nationally or locally," said Tim Castelli, Clear Channel's executive vice president for digital sales. "It's a playlist generator. It does not really deliver what radio does, which is that rich, personal experience."

Pandora and the radio companies have also tussled over audience measurement methods, and the broadcasters have moved onto Pandora's turf as well, with similar apps like Clear Channel's iHeartRadio.

But when it comes to signing up local businesses, advertising executives like Jeff Lancot of the digital advertising agency Razorfish, also part of Publicis, say that Pandora's success or failure may simply come down to how many salespeople it has in the field. CBS Radio, the second-largest broadcaster by revenue, has a sales staff of 1,200, said Michael Weiss, its president for sales; Pandora has fewer than half as many total employees.

"The boots on the ground," Mr. Lancot said, "gets you the local advertiser."

A version of this article appeared in print on April 16, 2012, on page B4 of the New York edition with the headline: Pandora Courts Local Advertisers, by Offering Well-Defined Listeners.

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