

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

Pandora Media, Inc.
Form 10-Q
October 27, 2016

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0001230276 us-gaap:DevelopedTechnologyRightsMember 2015-12-31 0001230276 us-gaap:PatentsMember
2015-12-31 0001230276 us-gaap:TradeNamesMember 2016-09-30 0001230276
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p:ConvertibleSeniorNotesDue2020Member us-gaap:DebtInstrumentRedemptionPeriodOneMember
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0001230276 p:ConvertibleSeniorNotesDue2020Member us-gaap:DebtInstrumentRedemptionPeriodThreeMember
us-gaap:ConvertibleDebtMember 2016-09-30 0001230276 us-gaap:LineOfCreditMember 2016-09-01 2016-09-30
0001230276 p:ConvertibleSeniorNotesDue2020Member us-gaap:ConvertibleDebtMember
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us-gaap:DebtInstrumentRedemptionPeriodThreeMember us-gaap:ConvertibleDebtMember 2016-01-01 2016-09-30
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2016-01-01 2016-09-30 0001230276 us-gaap:SellingAndMarketingExpenseMember 2016-07-01 2016-09-30
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us-gaap:GeneralAndAdministrativeExpenseMember 2015-01-01 2015-09-30 0001230276
p:ServiceAndProcessingCostsMember 2016-01-01 2016-09-30 0001230276 us-gaap:CostOfSalesMember 2015-01-01
2015-09-30 0001230276 us-gaap:CostOfSalesMember 2016-07-01 2016-09-30 0001230276
us-gaap:SellingAndMarketingExpenseMember 2015-01-01 2015-09-30 0001230276
p:ServiceAndProcessingCostsMember 2015-01-01 2015-09-30 0001230276
us-gaap:ResearchAndDevelopmentExpenseMember 2016-01-01 2016-09-30 0001230276
us-gaap:ResearchAndDevelopmentExpenseMember 2015-07-01 2015-09-30 0001230276
us-gaap:GeneralAndAdministrativeExpenseMember 2016-01-01 2016-09-30 0001230276
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2015-09-30 0001230276 us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2015-07-01
2015-09-30 0001230276 us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2016-07-01
2016-09-30 0001230276 us-gaap:EmployeeStockMember p:BlackScholesOptionsPricingModelMember 2016-01-01
2016-09-30 0001230276 us-gaap:EmployeeStockMember 2016-07-01 2016-09-30 0001230276
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0001230276 p:MarketStockUnitsMSUsMember 2015-07-01 2015-09-30 0001230276
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us-gaap:ShareBasedCompensationAwardTrancheThreeMember 2015-03-01 2015-03-31 0001230276
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2015-12-31 0001230276 us-gaap:PerformanceSharesMember 2016-07-01 2016-09-30 0001230276
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2015-03-31 0001230276 p:MarketStockUnitsMSUsMember us-gaap:MaximumMember
us-gaap:ShareBasedCompensationAwardTrancheTwoMember 2015-03-01 2015-03-31 0001230276
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us-gaap:ShareBasedCompensationAwardTrancheOneMember 2016-04-01 2016-04-30 0001230276
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2016-01-01 2016-09-30 0001230276 p:EmployeeAndNonEmployeeStockOptionsMember 2015-01-01 2015-09-30
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[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2016

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 **94-3352630**
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

2101 Webster Street, Suite 1650 **94612**
Oakland, CA

(Address of principal executive offices) (Zip Code)
(510) 451-4100

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(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 October 25, 2016 was: 233,335,503.

Table of Contents

Pandora Media, Inc.

FORM 10-Q Quarterly Report

Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of December 31, 2015 and September 30, 2016</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2015 and 2016</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the Three and Nine Months Ended September 30, 2015 and 2016</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2016</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>22</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>39</u>
<u>Item 4. Controls and Procedures</u>	<u>40</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>41</u>
<u>Item 1A. Risk Factors</u>	<u>41</u>
<u>Item 6. Exhibits</u>	<u>64</u>
<u>Signatures</u>	<u>65</u>

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

	As of December 31, 2015	As of September 30, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 334,667	\$ 207,695
Short-term investments	35,844	50,052
Accounts receivable, net of allowance of \$2,165 at December 31, 2015 and \$3,023 at September 30, 2016	277,075	282,802
Prepaid content acquisition costs	2,099	102,623
Prepaid expenses and other current assets	33,821	34,166
Total current assets	683,506	677,338
Long-term investments	46,369	6,273
Property and equipment, net	66,370	118,453
Goodwill	303,875	306,706
Intangible assets, net	110,745	95,565
Other long-term assets	29,792	32,528
Total assets	\$ 1,240,657	\$ 1,236,863
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 17,897	\$ 13,983
Accrued liabilities	37,185	33,968
Accrued content acquisition costs	97,390	106,275
Accrued compensation	43,788	52,089
Deferred revenue	19,939	31,971
Other current liabilities	15,632	20,739
Total current liabilities	231,831	259,025
Long-term debt, net	234,577	337,429
Other long-term liabilities	30,862	33,402
Total liabilities	497,270	629,856
Stockholders' equity		
Common stock: 224,970,412 shares issued and outstanding at December 31, 2015 and 233,312,446 at September 30, 2016	23	23
Additional paid-in capital	1,110,539	1,227,197
Accumulated deficit	(366,658)	(619,627)
Accumulated other comprehensive loss	(517)	(586)
Total stockholders' equity	743,387	607,007
Total liabilities and stockholders' equity	\$ 1,240,657	\$ 1,236,863

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

Table of Contents

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2016	2015	2016
Revenue				
Advertising	\$254,656	\$273,716	\$664,316	\$759,150
Subscription and other	56,906	56,100	163,570	165,957
Ticketing service	—	22,085	—	67,121
Total revenue	311,562	351,901	827,886	992,228
Cost of revenue				
Cost of revenue - Content acquisition costs	211,272	174,334	467,429	522,231
Cost of revenue - Other	21,414	25,556	57,690	71,388
Cost of revenue - Ticketing service	—	15,318	—	45,223
Total cost of revenue	232,686	215,208	525,119	638,842
Gross profit	78,876	136,693	302,767	353,386
Operating expenses				
Product development	21,849	33,657	56,466	103,311
Sales and marketing	107,286	116,475	285,595	357,909
General and administrative	35,603	41,768	111,169	128,626
Total operating expenses	164,738	191,900	453,230	589,846
Loss from operations	(85,862)	(55,207)	(150,463)	(236,460)
Interest expense	(131)	(6,494)	(386)	(18,916)
Other income, net	95	579	803	1,696
Total other income (expense), net	(36)	(5,915)	417	(17,220)
Loss before benefit from (provision for) income taxes	(85,898)	(61,122)	(150,046)	(253,680)
Benefit from (provision for) income taxes	(32)	(412)	(206)	711
Net loss	\$(85,930)	\$(61,534)	\$(150,252)	\$(252,969)
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	212,760	232,139	211,487	229,524
Net loss per share, basic and diluted	\$(0.40)	\$(0.27)	\$(0.71)	\$(1.10)

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

Table of Contents

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2016	2015	2016
Net loss	\$ (85,930)	\$ (61,534)	\$ (150,252)	\$ (252,969)
Change in foreign currency translation adjustment	(127)	(129)	(274)	(417)
Change in net unrealized gains (loss) on marketable securities	50	(45)	324	348
Other comprehensive income (loss)	(77)	(174)	50	(69)
Total comprehensive loss	\$ (86,007)	\$ (61,708)	\$ (150,202)	\$ (253,038)

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

Table of Contents

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

	Nine months ended	
	September 30,	
	2015	2016
Operating activities		
Net loss	\$(150,252)	\$(252,969)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	15,194	43,480
Stock-based compensation	79,473	103,841
Amortization of premium on investments, net	1,712	339
Other operating activities	1,610	2,884
Amortization of debt discount	—	13,587
Changes in operating assets and liabilities		
Accounts receivable	(45,796)	(8,338)
Prepaid content acquisition costs	(167)	(100,524)
Prepaid expenses and other assets	(6,397)	(12,655)
Accounts payable, accrued and other current liabilities	29,601	(4,990)
Accrued content acquisition costs	89,423	8,875
Accrued compensation	4,333	10,370
Other long-term liabilities	1,500	598
Deferred revenue	7,689	12,032
Reimbursement of cost of leasehold improvements	1,014	4,397
Net cash provided by (used in) operating activities	28,937	(179,073)
Investing activities		
Purchases of property and equipment	(21,336)	(46,400)
Internal-use software costs	(5,997)	(22,339)
Changes in restricted cash	—	(250)
Purchases of investments	(138,721)	(12,413)
Proceeds from maturities of investments	179,799	34,816
Proceeds from sale of investments	41,317	3,507
Payments related to acquisitions, net of cash acquired	(23,028)	(676)
Net cash provided by (used in) investing activities	32,034	(43,755)
Financing activities		
Borrowings under debt arrangements	—	90,000
Proceeds from employee stock purchase plan	5,089	6,395
Proceeds from exercise of stock options	3,718	3,011
Payment of debt issuance costs	—	(32)
Tax payments from net share settlements of restricted stock units	(2,295)	(3,126)
Net cash provided by financing activities	6,512	96,248
Effect of exchange rate changes on cash and cash equivalents	(459)	(392)
Net increase (decrease) in cash and cash equivalents	67,024	(126,972)
Cash and cash equivalents at beginning of period	175,957	334,667
Cash and cash equivalents at end of period	\$242,981	\$207,695
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	\$343	\$3,336
Purchases of property and equipment recorded in accounts payable and accrued liabilities	\$1,328	\$8,321

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

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of Business and Basis of Presentation

Pandora

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

Ticketing Service

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

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

Basis of Presentation

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

Certain changes in presentation have been made to conform the prior period presentation to current period reporting. We have reclassified certain amounts from the accounts payable, accrued and other current liabilities line item to the long-term liabilities line item of our condensed consolidated statements of cash flows. We have also reclassified internal-use software costs from the purchases of property and equipment line item to the internal-use software costs line item of our condensed consolidated statements of cash flows. We have also reclassified prepaid content acquisition costs from the prepaid expenses and other assets line item to the prepaid content acquisition costs line item of our condensed consolidated balance sheets and our condensed consolidated statements of cash flows. Lastly, we

have reclassified interest expense from the other income (expense), net line item to the interest expense line item of our condensed consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the related disclosures at the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Estimates are used in several areas including, but not limited to determining accrued content acquisition costs, amortization of minimum guarantees under content acquisition agreements, selling prices for elements sold in multiple-element arrangements, the allowance for doubtful accounts, the fair value of stock options, market stock units ("MSUs"), stock-settled performance-based RSUs ("PSUs") and the Employee Stock Purchase Plan ("ESPP"), the provision for (benefit from) income taxes and the impact of forfeitures on stock-based compensation. To the extent there are material differences between these estimates, judgments

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

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.

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 Annual Report on Form 10-K for the year ended December 31, 2015.

Prepaid Content Acquisition Costs

Prepaid content acquisition costs are primarily comprised of minimum guarantees under content acquisition agreements. From November 2015 through September 2016, we signed direct license agreements for recorded music with major and independent labels, distributors and publishers. Certain of these license agreements include minimum guarantee payments, some of which are paid in advance. These minimum guarantees may take the form of either a contractually obligated minimum over a specified period of time that requires a true-up payment at the end of the specified period if the cumulative payments have not met or exceeded the specified minimum, or cash advance payments made at the beginning of, or at intervals during, the specified period, which cash payments are then recoupable against content acquisition costs over the specified period. On a quarterly basis, we record the greater of the cumulative actual content acquisition costs incurred or the cumulative minimum guarantee based on forecasted usage for the minimum guarantee period. The minimum guarantee period is the period of time that the minimum guarantee relates to, as specified in each agreement, which may be annual or a longer period. The cumulative minimum guarantee, based on forecasted usage considers factors such as listening hours, revenue, subscribers and other terms of each agreement that impact our expected attainment or recoupment of the minimum guarantees on a non-straight line basis.

Concentration of Credit Risk

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

Recently Issued Accounting Standards

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

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, *Going Concern (Subtopic 205-40)* ("ASU 2014-15"). ASU 2014-15 requires management of all entities to evaluate whether there are conditions

and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued when applicable). The guidance is effective for fiscal years beginning after December 15, 2016 and for interim periods within that fiscal year. We do not expect the adoption of this guidance to have a material effect on our consolidated financial statements.

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

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

currently evaluating implementation methods and the effect that implementation of this standard will have on our consolidated financial statements upon adoption.

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

3. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments consisted of the following:

	As of December 31, 2015 (in thousands)	As of September 30, 2016 (in thousands)
Cash and cash equivalents		
Cash	\$ 104,361	\$ 130,132
Money market funds	180,021	33,446
Commercial paper	31,089	35,904
Corporate debt securities	2,000	8,213
U.S. government and government agency debt securities	17,196	—
Total cash and cash equivalents	\$ 334,667	\$ 207,695
Short-term investments		
Commercial paper	\$ 4,792	\$ 1,000
Corporate debt securities	31,052	49,052
Total short-term investments	\$ 35,844	\$ 50,052
Long-term investments		
Corporate debt securities	\$ 46,369	\$ 6,273
Total long-term investments	\$ 46,369	\$ 6,273
Cash, cash equivalents and investments	\$ 416,880	\$ 264,020

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

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

As of December 31, 2015			
Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
(in thousands)			

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Money market funds	\$ 180,021	\$ —	\$ —	\$ 180,021
Commercial paper	35,881	—	—	35,881
Corporate debt securities	79,760	8	(347)) 79,421
U.S. government and government agency debt securities	17,198	—	(2)) 17,196
Total cash equivalents and marketable securities	\$ 312,860	\$ 8	\$ (349)) \$ 312,519

9

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

	As of September 30, 2016			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
Money market funds	\$33,446	\$ —	\$ —	\$33,446
Commercial paper	36,904	—	—	36,904
Corporate debt securities	63,531	26	(19)	63,538
Total cash equivalents and marketable securities	\$133,881	\$ 26	\$ (19)	\$133,888

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

	As of December 31, 2015	
	Adjusted Cost	Fair Value
	(in thousands)	
Due in one year or less	\$266,205	\$266,150
Due after one year through three years	46,655	46,369
Total	\$312,860	\$312,519
	As of September 30, 2016	
	Adjusted Cost	Fair Value
	(in thousands)	
Due in one year or less	\$127,629	\$127,615
Due after one year through three years	6,252	6,273
Total	\$133,881	\$133,888

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

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

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

	As of September 30, 2016					
	Twelve Months or Less		More than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Corporate debt securities	\$33,240	\$ (12)	\$8,843	\$ (7)	\$42,083	\$ (19)
Total	\$33,240	\$ (12)	\$8,843	\$ (7)	\$42,083	\$ (19)

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 September 30, 2016 were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of September 30, 2016, we owned 32 securities that were in an unrealized loss position. Based on our cash flow needs, we may be required to sell a portion of these securities prior to maturity. However, we expect to recover the full carrying value of these securities. As a result, no portion of the unrealized losses at September 30, 2016 is deemed to be other-than-temporary and the unrealized losses are not deemed to be credit losses. When evaluating the investments for other-than-temporary impairment, we review factors such as the length of time and extent 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 nine months ended September 30, 2016, we did not recognize any impairment charges. During the three and nine months ended September 30, 2016, we had proceeds from the sale of available-for-sale securities of \$3.0 million and \$3.5 million. We did not recognize a realized gain or loss in connection with these sales.

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

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

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

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

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

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

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

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

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

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(Level 1)
(in thousands)

Assets			
Money market funds	\$ 33,446	\$ —	\$ 33,446
Commercial paper	—	36,904	36,904
Corporate debt securities	—	63,538	63,538
Total assets measured at fair value	\$ 33,446	\$ 100,442	\$ 133,888

12

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

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

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

5. Commitments and Contingencies

Minimum Guarantees - Content Acquisition Costs

Certain of our content acquisition agreements contain minimum guarantees, and require that we make upfront minimum guarantee payments. As of September 30, 2016, we have future minimum guarantee commitments of \$780.1 million, of which \$18.1 million will be paid in the three months ended December 31, 2016, \$354.9 million will be paid in 2017 and the remainder will be paid thereafter. On a quarterly basis, we record the greater of the cumulative actual content acquisition costs incurred or the cumulative minimum guarantee based on forecasted usage for the minimum guarantee period. The minimum guarantee period is the period of time that the minimum guarantee relates to, as specified in each agreement, which may be annual or a longer period. The cumulative minimum guarantee, based on forecasted usage considers factors such as listening hours, revenue, subscribers and other terms of each agreement that impact our expected attainment or recoupment of the minimum guarantees on a non-straight line basis.

Legal Proceedings

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

Pre-1972 copyright litigation

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

In October 2015, the parties reached an agreement ("pre-1972 settlement") whereby we agreed to pay the plaintiffs a total of \$90 million. The settlement resolves all past claims as to our use of pre-1972 recordings owned or controlled by the plaintiffs and enables us, without any additional payment, to reproduce, perform and broadcast such recordings in the United States through December 31, 2016. This agreement was approved by our board of directors and executed

on October 21, 2015. Pursuant to this settlement, we paid the plaintiffs \$60 million in October 2015 and the plaintiffs dismissed the case with prejudice. As a result, cost of revenue - content acquisition costs increased by \$65.4 million in the twelve months ended December 31, 2015, of which \$57.9 million was related to a one-time cumulative charge to cost of revenue - content acquisition costs related to pre-1972 spins played through September 30, 2015. The remaining charge of \$24.6 million will be recorded in cost of revenue - content acquisition costs in 2016 based on the allocation of pre-1972 listening throughout the remainder of the settlement period. The pre-72 settlement further required that we make four additional installment payments of \$7.5 million each. The first was paid in December 2015, the second was paid in March 2016, the third was paid in June 2016 and the final installment was paid in September 2016.

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

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

the complaint pursuant to California's Anti-Strategic Lawsuit Against Public Participation ("Anti-SLAPP") statute. This motion was denied, and we have appealed the ruling to the Ninth Circuit Court of Appeals. As a result, the district court litigation has been stayed pending the Ninth Circuit's review. The Ninth Circuit has scheduled oral argument on December 8, 2016.

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

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

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

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

On September 7, 2016, Ponderosa Twins Plus One et al. filed a class action suit against Pandora Media, Inc. in the federal district court for the Southern District of California. The complaint alleges common law copyright infringement, violation of the California Civil Code, misappropriation, unfair business practices and conversion arising from allegations that we owe royalties for the public performance of sound recordings recorded prior to February 15, 1972. On October 5, 2016, the district court transferred the case to the federal district court for the Northern District of California. On October 21, 2016, the Court granted the parties' stipulation to stay the district court action pending the Ninth Circuit's review of Pandora's appeal in Flo & Eddie et al. v. Pandora Media, Inc., which involves similar allegations.

The outcome of any litigation is inherently uncertain. Except as noted above, we do not believe it is probable that the final outcome of the matters discussed above will, individually or in the aggregate, have a material adverse effect on our business, financial position, results of operations or cash flows; however, in light of the uncertainties involved in

such matters, there can be no assurance that the outcome of each case or the costs of litigation, regardless of outcome, will not have a material adverse effect on our business. In particular, rate court proceedings could take years to complete, could be very costly and may result in current and past rates for content acquisition costs that are materially less favorable than rates we currently pay or have paid in the past.

Indemnification Agreements, Guarantees and Contingencies

In the ordinary course of business, we are party to certain contractual agreements under which we may provide indemnifications of varying scope, terms and duration to customers, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of such agreements, services to be provided by us or from intellectual property infringement claims made by third parties. In addition, we have entered into indemnification agreements with directors and certain officers and employees that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers or employees. Such

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

indemnification provisions are accounted for in accordance with guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others. To date, we have not incurred, do not anticipate incurring and therefore have not accrued for, any costs related to such indemnification provisions.

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

6. Goodwill and Intangible Assets

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

	Goodwill (in thousands)
Balance as of December 31, 2015	\$ 303,875
Goodwill resulting from business combination and purchase price adjustments	2,831
Balance as of September 30, 2016	\$ 306,706

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

	As of December 31, 2015			As of September 30, 2016		
	Gross Carrying Amount (in thousands)	Accumulated Amortization (in thousands)	Net Carrying Value	Gross Carrying Amount (in thousands)	Accumulated Amortization (in thousands)	Net Carrying Value
Finite-lived intangible assets						
Patents	\$8,030	\$ (1,824)	\$ 6,206	\$8,030	\$ (2,373)	\$ 5,657
Developed technology	56,050	(1,265)	54,785	56,165	(10,515)	45,650
Customer relationships - clients	37,300	(777)	36,523	37,399	(4,309)	33,090
Customer relationships - users	1,940	(318)	1,622	1,940	(1,046)	894
Trade names	11,720	(304)	11,416	11,735	(1,654)	10,081
Total finite-lived intangible assets	\$115,040	\$ (4,488)	\$ 110,552	\$115,269	\$ (19,897)	\$ 95,372
Indefinite-lived intangible assets						
FCC license - Broadcast Radio	\$ 193	\$ —	\$ 193	\$ 193	\$ —	\$ 193
Total intangible assets	\$115,233	\$ (4,488)	\$ 110,745	\$115,462	\$ (19,897)	\$ 95,565

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Amortization expense of intangible assets was \$0.4 million and \$5.1 million for the three months ended September 30, 2015 and 2016. Amortization expense of intangible assets was \$0.8 million and \$15.4 million for the nine months ended September 30, 2015 and 2016.

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

15

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

	As of September 30, 2016 (in thousands)
Remainder of 2016	\$ 5,138
2017	20,116
2018	17,654
2019	17,129
2020	15,896
Thereafter	19,439
Total future amortization expense	\$ 95,372

7. Debt Instruments

Long-term debt, net consisted of the following:

	As of December 31, 2015 (in thousands)	As of September 30, 2016
1.75% convertible senior notes due 2020	\$ 345,000	\$ 345,000
Credit facility	—	90,000
Unamortized discount and deferred issuance costs	(110,423)	(97,571)
Long-term debt, net	\$ 234,577	\$ 337,429

Convertible Debt Offering

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

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

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

time.

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

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

16

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

27.3 million, and is subject to adjustment under certain circumstances.

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

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

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

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

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

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

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

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

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

Three	Nine
months	months
ended	ended
September	September
30,	30,
2016	

**(in thousands except
for effective interest
rate)**

Effective interest rate	10.18 %	10.18 %
Contractually stated interest expense	\$ 1,505	\$ 4,536
Amortization of discount	\$ 4,649	\$ 13,587

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

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

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

The total estimated fair value of the Notes as of September 30, 2016 was \$362.1 million. The fair value was determined using a methodology that combines direct market observations with quantitative pricing models to generate evaluated prices. We consider the fair value of the Notes to be a Level 2 measurement due to the limited trading activity of the Notes.

The closing price of our common stock was \$14.33 on September 30, 2016, which was less than the initial conversion price for the Notes of approximately \$16.42 per share. As such, the if-converted value of the Notes was less than the principal amount of \$345.0 million.

Credit Facility

We are party to a \$120.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. In September 2016, we borrowed \$90.0 million from the credit facility to enhance our working capital position. The amount borrowed is included in long-term debt on our balance sheet. Interest is payable quarterly at the applicable annual interest rate of 3.81% through September 2017. The applicable interest rate will be adjusted in September 2017.

As of September 30, 2016, we had \$1.2 million in letters of credit outstanding and \$28.8 million of available borrowing capacity under the credit facility. We are in compliance with all financial covenants associated with the credit facility as of September 30, 2016.

8. Stock-based Compensation Plans and Awards

ESPP

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

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

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

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	Three months ended September 30,		Nine months ended September 30,	
	2015	2016	2015	2016
Expected life (in years)	0.5	0.5	0.5	0.5
Risk-free interest rate	0.07 - 0.24%	0.41 - 0.44%	0.05 - 0.24%	0.24 - 0.44%
Expected volatility	29 - 42%	41 - 52%	29 - 42%	41 - 52%
Expected dividend yield	0	% 0	% 0	% 0

During the three months ended September 30, 2015 and 2016, we withheld \$1.8 million and \$2.6 million in contributions from employees and recognized \$0.6 million and \$0.9 million of stock-based compensation expense related to the ESPP, respectively. During the nine months ended September 30, 2015 and 2016, we withheld \$5.1 million and \$6.4 million in contributions from employees and recognized \$1.9 million and \$2.3 million of stock-based compensation expense related to the ESPP, respectively. In the three months ended September 30, 2015 and 2016, 255,432 and 643,562 shares of common stock

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

were issued under the ESPP. In the nine months ended September 30, 2015 and 2016, 538,398 and 1,254,910 shares of common stock were issued under the ESPP.

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 expense for stock options at the grant date fair value of the award and recognize expense 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 September 30, 2015 and 2016, we recorded stock-based compensation expense from stock options of approximately \$2.3 million and \$2.2 million. During the nine months ended September 30, 2015 and 2016, we recorded stock-based compensation expense from stock options of approximately \$7.5 million and \$11.3 million.

There were no options granted in the three and nine months ended September 30, 2016.

Restricted stock units ("RSUs")

The fair value of RSUs is expensed ratably over the vesting period. RSUs typically have an initial annual cliff vest and then vest quarterly thereafter over the service period, which is generally four years. During the three months ended September 30, 2015 and 2016, we recorded stock-based compensation expense from RSUs of approximately \$25.4 million and \$28.2 million. During the nine months ended September 30, 2015 and 2016, we recorded stock-based compensation expense from RSUs of approximately \$69.1 million and \$87.2 million.

MSUs

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

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

- One-third of the target MSUs are eligible to be earned for a performance period that is the first calendar year of the MSU grant (the "One-Year Performance Period");
- One-third of the target MSUs are eligible to be earned for a performance period that is the first two calendar years of the MSU grant (the "Two-Year Performance Period"); and
- Any remaining portion of the total potential MSUs are eligible to be earned for a performance period that is the entire three calendar years of the MSU grant (the "Three-Year Performance Period").

For each performance period, a "performance multiplier" is calculated by comparing Pandora's TSR for the period to the Russell 2000 Index TSR for the same period, using the average adjusted closing stock price of Pandora stock, and

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

Table of Contents

Pandora Media, Inc.

Notes to Condensed Consolidated Financial Statements - Continued

(unaudited)

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

During the nine months ended September 30, 2015 we granted 776,000 MSUs at a total grant-date fair value of \$4.3 million. There were no MSUs granted in the three or nine months ended September 30, 2016. During the three months ended September 30, 2015 and 2016, we recorded stock-based compensation expense from MSUs of approximately \$0.5 million and \$0.2 million. During the nine months ended September 30, 2015 and 2016, we recorded stock-based compensation expense from MSUs of approximately \$1.0 million and \$0.6 million.

In February 2016, the compensation committee of the board of directors certified the results of the One-Year Performance Period of the 2015 MSU grant, which concluded December 31, 2015. During the One-Year Performance Period, our relative TSR declined 26 percentage points relative to the Russell 2000 Index TSR for the period, which resulted in the vesting of the One-Year Performance Period at 22% of the one-third vesting opportunity for the period.

PSUs

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

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

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

During the nine months ended September 30, 2016 we granted 1,725,000 PSUs at a total grant-date fair value of \$8.7 million. There were no PSUs granted in the three or nine months ended September 30, 2015. During the three and nine months ended September 30, 2016, we recorded stock-based compensation expense from PSUs of approximately \$1.3 million and \$2.4 million. There was no stock-based compensation expense from PSUs in the three or nine months ended September 30, 2015.

Stock-based Compensation Expense

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

Three months ended September 30,	Nine months ended September 30,
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	2015	2016	2015	2016
	(in thousands)		(in thousands)	
Stock-based compensation expense				
Cost of revenue - Other	\$1,427	\$1,538	\$4,040	\$4,559
Cost of revenue - Ticketing service	—	27	—	154
Product development	6,189	7,347	16,148	23,091
Sales and marketing	13,732	14,932	38,403	43,673
General and administrative	7,446	8,910	20,882	32,364
Total stock-based compensation expense	\$28,794	\$32,754	\$79,473	\$103,841

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

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

9. Net Loss Per Share

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

Diluted net loss per share is computed by giving effect to all potential shares of common stock, including stock options, restricted stock units, market stock units and performance-based RSUs, to the extent dilutive. Basic and diluted net loss per share were the same for the three and nine months ended September 30, 2015 and 2016, 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 September 30,		Nine months ended September 30,	
	2015	2016	2015	2016
	(in thousands except per share amounts)		(in thousands except per share amounts)	
Numerator				
Net loss	\$ (85,930)	\$ (61,534)	\$ (150,252)	\$ (252,969)
Denominator				
Weighted-average common shares outstanding used in computing basic and diluted net loss per share	212,760	232,139	211,487	229,524
Net loss per share, basic and diluted	\$ (0.40)	\$ (0.27)	\$ (0.71)	\$ (1.10)

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 September 30,	
	2015	2016
	(in thousands)	
Options to purchase common stock	10,492	9,665
Restricted stock units	16,653	23,554
Performance awards*	776	2,315
Total common stock equivalents	27,921	35,534

*Includes potential common shares outstanding for MSUs and PSUs

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

period from the issuance of the offering of the Notes through September 30, 2016, the conversion feature of the Notes was anti-dilutive.

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

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")

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

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

Some of the industry and market data contained in this Quarterly Report on Form 10-Q are based on independent industry publications, including those generated by Triton Digital Media ("Triton") or other publicly available information. This information involves a number of assumptions and limitations. Although we believe that each source is reliable as of its respective date, we have not independently verified the accuracy or completeness of this information.

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

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

Overview

Pandora - Internet Radio Service

Pandora is the world's most powerful music discovery platform, offering a personalized experience for each of our listeners wherever and whenever they want to listen to music—whether through earbuds, car speakers or live on stage. Our vision is to be the definitive source of music discovery and enjoyment for billions. The majority of our listener hours occur on mobile devices, with the majority of our revenue generated from advertising on these devices. We

offer both local and national advertisers the opportunity to deliver targeted messages to our listeners using a combination of audio, display and video advertisements. Founded by musicians, Pandora also empowers artists with valuable data and tools to help grow their careers and connect with their fans.

For the three months ended September 30, 2016, we streamed 5.40 billion hours of radio, and as of September 30, 2016, we had 77.9 million active users during the prior 30-day period. Since we launched our non-subscription, ad-supported radio service in 2005 our listeners have created over 10 billion stations.

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

Table of Contents

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

We currently provide the Pandora service through two models:

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

Subscription Service. Our new subscription service, Pandora Plus, launched on September 15, 2016. Prior to September 15, 2016, our subscription service was Pandora One. Our subscription service is a premium monthly or annual paid version of the Pandora service, which currently includes advertisement-free access, higher quality audio on supported devices and longer timeout-free listening. Pandora Plus also includes additional features such as replays, unlimited skips and offline listening.

A key element of our strategy is to make the Pandora service available everywhere that there is internet connectivity. To this end, we make the Pandora service available through a variety of distribution channels. In addition to streaming our service to computers, we have developed Pandora mobile device applications ("apps") for smartphones and mobile operating systems, such as the iPhone, Android and the Windows Phone and for tablets including the iPad and Android tablets. We distribute those mobile apps free to listeners via app stores.

Our new subscription service, Pandora Plus, launched on September 15, 2016 and we intend to unveil a subscription-based on-demand music streaming service in the coming months. The development and launch of our recent and planned new service offerings have and will continue to require significant engineering effort, as well as marketing, and other resources. In addition, to support the launch of these services we have entered into direct license agreements with the major and independent record labels, some of which include substantial minimum guarantee payments. To successfully launch such additional service offerings, we will need to attract subscribers to these new service offerings. The market for subscription-based music services, including on-demand services, is intensely competitive, and our ability to realize a return on our investments in these new service offerings will depend on our ability to leverage the existing audience of our ad-supported service, our brand awareness and deliver differentiated subscription services with features and functionality that listeners find attractive. Refer to our discussion of these matters in Item 1A - "Risk factors".

Ticketing Service

Our ticketing service consists of Ticketfly, a leading live events technology company that provides ticketing and marketing software and services for venues and event promoters across North America. Ticketfly's ticketing, digital marketing and analytics software helps promoters book talent, sell tickets and drive in-venue revenue, while Ticketfly's consumer tools help fans find and purchase tickets to events. Tickets are primarily sold through the Ticketfly platform but are also sold through other channels such as box offices. In the three months ended September 30, 2016, Ticketfly had approximately 40 thousand live events on sale, for which approximately 3.9 million tickets, excluding box office sales, were sold to approximately 1.7 million unique ticket buyers, which resulted in more than \$155 million in gross transaction value, excluding box office sales. We completed the acquisition of Ticketfly on October 31, 2015.

Ticketfly's platform provides ticketing and marketing services for venues and event promoters across North America and makes it easy for fans to find and purchase tickets to events, and also gives artists a means to more effectively promote their events. We intend to expand our ticketing service by connecting our listeners to events through our internet radio service.

Recent Events

Content Acquisition License Agreements

From November 2015 to September 2016, we signed direct license agreements for recorded music with major and independent labels, distributors and publishers. These agreements allow us to provide new and improved products to the market that include enhanced features such as replays, offline stations and on-demand listening. Certain of these license agreements include minimum guarantee payments, some of which are paid in advance. These minimum guarantee payments resulted in a material impact to the prepaid content acquisition costs line item in our condensed consolidated balance sheets. Refer to Note 2 "Summary of Significant Accounting Policies" in the Notes to Condensed Consolidated Financial Statements for further details on our prepaid content acquisition costs policy and minimum guarantees.

Pandora Plus and New Ad-Supported Service Features

23

Table of Contents

On September 15, 2016, we announced the launch of Pandora Plus, an updated version of our subscription service. The updated service includes replays, additional skipping and offline listening. In addition, new features were also added to our ad-supported service, allowing listeners to skip more songs and replay songs by viewing a video ad.

Factors Affecting our Business Model

Content Acquisition Costs

Prior to the launch of Pandora Plus on September 15, 2016, we paid performance rates for the sound recordings we streamed on our ad-supported service and our Pandora One subscription service according to the Web IV rates set by the Copyright Royalty Board on December 16, 2015. The rates for non-subscription services were set at \$0.0017 per play and the rates for subscription services were set at \$0.0022 per play for 2016.

During the three and nine months ended September 30, 2016, we entered into direct license agreements with major and independent music labels. Subsequent to the launch of Pandora Plus on September 15, 2016, we began paying content acquisition costs based on the terms of these license agreements for the significant majority of the sound recordings we stream on our ad-supported service and Pandora Plus. These agreements are structured so that content acquisition costs for our ad-supported service are based on the number of sound recordings we transmit or a percentage of advertising revenue, subject to certain discounts, and content acquisition costs for our subscription service are determined as the greater of a percentage of subscription revenue or a per subscriber minimum amount, subject to certain discounts. Certain of these license agreements require minimum guarantee payments, some of which are paid in advance. Refer to Note 2 "Summary of Significant Accounting Policies" in the Notes to Condensed Consolidated Financial Statements for further details on our prepaid content acquisition costs policy and minimum guarantees.

If we have not entered into a license agreement with the copyright owner of a particular sound recording that is streamed on our ad-supported service or our subscription service, our content acquisition costs for such sound recordings are calculated based on the number of sound recordings streamed at the per-performance rates that apply to commercial webcasters under the Web IV rates set by the Copyright Royalty Board on December 16, 2015.

Content acquisition costs for musical works are most often negotiated with and paid to performing rights organizations ("PROs") such as ASCAP, BMI, SESAC and Global Music Rights ("GMR") and directly to publishing companies. During the twelve months ended December 31, 2015 and the nine months ended September 30, 2016, we entered into direct licenses with ASCAP, BMI, SESAC and thousands of music publishers. These licenses are structured so that, for our ad-supported service, each publisher or PRO receives its usage-based share of a content acquisition cost pool equal to 20% of the content acquisition costs paid by us for sound recordings. Prior to the launch of Pandora Plus on September 15, 2016, these licenses were structured so that, for our subscription service, each publisher or PRO receives its usage-based share of a content acquisition cost pool equal to 20% of the content acquisition costs paid by us for sound recordings. Subsequent to the launch of Pandora Plus, content acquisition costs for our subscription services are determined in accordance with the statutory license set forth in 17 U.S.C. Sec. 115 based on a percentage of revenue or a per subscriber minimum amount.

Ad-Supported Service

Our ad-supported service is monetized through the sale of display, audio and video advertisements to national, regional and local advertisers. We compete with digital advertising networks such as Google and Facebook, other digital media companies and local broadcast radio stations in our advertising business.

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

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

Cost of Revenue—Content Acquisition Costs—Ad-Supported Service. We pay content acquisition costs to the copyright owners and performers, or their agents, of each sound recording that we stream, as well as to the publishers and songwriters, or their agents, for the musical works embodied in each of those sound recordings, subject to certain

exclusions. Subsequent to the launch of Pandora Plus on September 15, 2016, the majority of the content acquisition costs related to our ad-supported service are driven by license agreements that require us to pay fees based on the number of sound recordings we transmit to users of the Pandora service or a percentage of advertising revenue, subject to certain discounts. These license agreements include minimum guarantee payments of content acquisition costs, some of which are paid in advance. Refer to Note 2 "Summary of Significant

Table of Contents

Accounting Policies" in the Notes to Condensed Consolidated Financial Statements for further details on our prepaid content acquisition costs policy and minimum guarantees.

Given the per-play cost structure of our license agreements for our ad-supported service, our content acquisition costs related to our ad-supported service increase with each additional listener hour, regardless of whether we are able to generate more revenue. As such, our ability to achieve and sustain profitability and operating leverage on our ad-supported service depends on our ability to increase our revenue per hour of streaming through increased advertising revenue across all of our delivery platforms.

Subscription Service

We monetize our subscription service through subscription payments made by users of the service. We drive subscriber growth in our subscription service by providing the world's most powerful music discovery platform, offering a personalized experience for each of our listeners. In addition, we invest in marketing and free-trials to promote our service.

Our total number of paid subscriptions is a key driver for both subscription revenue and, subsequent to the launch of Pandora Plus on September 15, 2016, for content acquisition costs related to our subscription service, which is the largest component of our subscription-related expenses. In order to drive greater subscription revenue, we must increase the number of new subscribers to our subscription service and minimize the number of current subscribers who discontinue their subscriptions.

Subscription Revenue. Our subscription revenue depends upon the number of paid subscriptions we are able to sell and the price that our subscribers pay for those subscriptions. Our ability to attract subscribers depends in large part on our ability to offer features and functionality on our subscription service that are valued by consumers within desired demographics, on terms that are attractive to those consumers, and still enable us to maintain adequate gross margins.

Cost of Revenue—Content Acquisition Costs—Subscription Service. We pay content acquisition costs to the copyright owners, performers, songwriters, or their agents, subject to certain exclusions. Subsequent to the launch of Pandora Plus on September 15, 2016, the majority of our content acquisition costs for our subscription service are calculated based on subscription revenue earned and subject to per subscriber minimum amounts, both of which are subject to certain discounts. These license agreements include minimum guarantee payments, some of which are paid in advance. Refer to Note 2 "Summary of Significant Accounting Policies" in the Notes to Condensed Consolidated Financial Statements for further details on our prepaid content acquisition costs policy and minimum guarantees.

Given the structure of our license agreements for our subscription service, the majority of our content acquisition costs increase as subscription revenue increases and are subject to minimum guarantee payments. As such, our ability to achieve and sustain profitability and operating leverage on our subscription service depends on our ability to increase our revenue through increased paid subscriptions on terms that maintain an adequate gross margin. Refer to our discussion of these matters in Item 1A - "Risk factors".

Key Metrics

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

Listener Hours

We track listener hours because it is a key indicator of the growth of our business. Beginning with the listener hours disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, we include listener hours related to our non-radio content offerings in the definition of listener hours. These offerings include non-music content such as podcasts, as well as custom music content such as Pandora Premiers and artist mixtapes. Historically, listener hours related to non-radio content represented a negligible number of listener hours. Including non-radio content in

the listener hours we have previously reported for the three and nine months ended September 30, 2015 would not have changed the reported listener hours. We calculate listener hours based on the total bytes served for each track that is requested and served from our servers, as measured by our internal analytics systems, whether or not a listener listens to the entire track. For non-music content such as podcasts, episodes are divided into approximately track-length parts, which are treated as tracks under this definition. To the extent that third-party measurements of listener hours are not calculated using a similar server-based approach, the third-party measurements may differ from our measurements.

Table of Contents

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

	Three months ended September 30, 2015	2016	Nine months ended September 30, 2015	2016
Listener hours	5.14	5.40	15.74	16.57

Active Users

We track the number of active users as an additional indicator of the breadth of audience we are reaching at a given time. We define active users as the number of distinct registered users, including subscribers, that have requested audio from our servers within the trailing 30 days to the end of the final calendar month of the period. The number of active users may overstate the number of unique individuals who actively use our service within a month as one individual may register for, and use, multiple accounts. Beginning with the active users disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, we are also including active users who only request non-radio content offerings in the definition of active users. Including users who only request non-radio content in the calculation of active users would not have materially changed the reported active users as of September 30, 2015. The table below sets forth our total active users as of September 30, 2015 and 2016.

	As of September 30, 2015	2016
Active users	78.1	77.9

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

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

User type	As of September 30, 2015	2016
Ad-based active users	74.7	74.5
Subscribers*	3.9	4.0
Total	78.6	78.5

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

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

User type	Three months ended		Nine months ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
Ad-based active users	4.48	4.71	13.77	14.53
Subscribers	0.66	0.69	1.97	2.04
Total	5.14	5.40	15.74	16.57

Table of Contents

Advertising Revenue per Thousand Listener Hours ("ad RPMs")

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

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

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

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

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

LPMs

Prior to the launch of Pandora Plus on September 15, 2016, LPMs were relatively fixed content acquisition costs with scheduled annual rate adjustments, per thousands of listener hours. Subsequent to September 15, 2016, LPMs are our content acquisition costs as calculated either under the rates set by our license agreements with record labels, PROs and music publishers or under the Web IV rates if we have not entered into a license agreement with the copyright owner of a particular sound recording, in each case per thousands of listener hours.

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

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

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

Three months ended			
September 30,			
	2015	2016	
	RPM	LPM	RPM LPM

Advertising	\$56.84	\$36.46	\$58.10	\$31.60
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Subscription	85.28	72.10	81.69	37.16
Total	\$60.52	\$41.06	\$61.09	\$32.31

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

27

Table of Contents

	Nine months ended			
	September 30,			
	2015		2016	
	RPM	LPM	RPM	LPM
Advertising	\$48.24	\$26.79	\$52.26	\$30.90
Subscription	82.84	49.95	80.98	35.88
Total	\$52.57	\$29.69	\$55.80	\$31.52

Advertising RPMs

For the three months ended September 30, 2016 compared to 2015, the increase in advertising RPMs was primarily due to the growth in advertising revenue outpacing the growth in advertising listener hours as a result of an increase in the number of ads sold.

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

Subscription RPMs

For the three months ended September 30, 2016 compared to 2015, the decrease in subscription RPMs was due to growth in subscription listening hours and a decrease in subscription and other revenue.

For the nine months ended September 30, 2016 compared to 2015, the decrease in subscription RPMs was due to the growth in subscription listening hours outpacing the growth in subscription and other revenue.

Advertising LPMs

For the three months ended September 30, 2016 compared to 2015, advertising LPMs decreased as a result of the one-time cumulative charges in the three months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty rate from June 2013 to September 2015, offset by an increase in the rate for content acquisition costs of 21% on our advertising-supported platform related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015 and increases in content acquisition costs paid to PROs and publishers due to the cost structure of our new publishing licenses.

For the nine months ended September 30, 2016 compared to 2015, advertising LPMs increased as a result of royalty rate increases of 21% on our advertising-supported platform related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015 and increases in content acquisition costs paid to PROs and publishers due to the cost structure of our new publishing licenses. This increase was offset by the one-time cumulative charges in the three months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty rate from June 2013 to September 2015.

Subscription LPMs

For the three and nine months ended September 30, 2016 compared to 2015, subscription LPMs decreased as a result of the one-time cumulative charges in the three months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty rate from June 2013 to September 2015 and a decrease in the rate for content acquisition costs of 12% on our subscription-supported platform related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015, offset by increases in content acquisition costs paid to PROs and publishers under the content acquisition cost structure of our new publishing licenses.

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.

Table of Contents

	Three months ended September 30, 2015		2016		Nine months ended September 30, 2015		2016	
Revenue								
Advertising	82	% 78	%	80	% 77	%		
Subscription and other	18	16		20	17			
Ticketing service	—	6		—	7			
Total revenue	100	100		100	100			
Cost of revenue								
Cost of revenue — Content acquisition costs	68	50		56	53			
Cost of revenue — Other (1)	7	7		7	7			
Cost of revenue — Ticketing service (1)	—	4		—	5			
Total cost of revenue	75	61		63	64			
Gross profit	25	39		37	36			
Operating expenses								
Product development (1)	7	10		7	10			
Sales and marketing (1)	34	33		34	36			
General and administrative (1)	11	12		13	13			
Total operating expenses	53	55		55	59			
Loss from operations	(28)	(16)		(18)	(24)			
Interest expense	—	(2)		—	(2)			
Other income, net	—	—		—	—			
Total other expense, net	—	(2)		—	(2)			
Loss before provision for income taxes	(28)	(17)		(18)	(26)			
Provision for income taxes	—	—		—	—			
Net loss	(28)%	(17)%		(18)%	(25)%			

(1) Includes stock-based compensation as follows:

Cost of revenue - Other	0.5 %	0.4 %	0.5 %	0.5 %
Cost of revenue - Ticketing service	—	—	—	—
Product development	2.0	2.1	2.0	2.3
Sales and marketing	4.4	4.2	4.6	4.4
General and administrative	2.4	2.5	2.5	3.3

Note: Amounts may not recalculate due to rounding

Revenue

	Three months ended September 30, 2015			2016			Nine months ended September 30, 2015			2016		
			\$ Change			\$ Change			\$ Change			\$ Change
	(in thousands)			(in thousands)			(in thousands)			(in thousands)		
Revenue												
Advertising	\$254,656	\$273,716	\$19,060	\$664,316	\$759,150	\$94,834						
Subscription and other	56,906	56,100	(806)	163,570	165,957	2,387						
Ticketing service	—	22,085	22,085	—	67,121	67,121						
Total revenue	\$311,562	\$351,901	\$40,339	\$827,886	\$992,228	\$164,342						

Advertising revenue

29

Table of Contents

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 September 30, 2015 and 2016 and the nine months ended September 30, 2015 and 2016, advertising revenue accounted for 82%, 78%, 80% and 77%, of our total revenue, respectively. We expect that advertising will comprise a substantial majority of our revenue for the foreseeable future.

For the three months ended September 30, 2016 compared to 2015, advertising revenue increased \$19.1 million or 7%, primarily due to an approximate 5% increase in the number of ads sold.

For the nine months ended September 30, 2016 compared to 2015, advertising revenue increased \$94.8 million or 14%, primarily due to an approximate 15% increase in the average price per ad due in part to our increase in relative volume of local ad sales and our focus on monetizing mobile inventory.

Subscription and other revenue

Prior to the launch of Pandora Plus on September 15, 2016, subscription and other revenue was generated primarily through the sale of Pandora One. Subsequent to September 15, 2016, subscription and other revenue is generated primarily through the sale of Pandora Plus. Pandora Plus is an enhanced version of the Pandora service, which currently includes enhanced product features such as replays, additional skipping and offline listening, together with our 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 September 30, 2015 and 2016 and the nine months ended September 30, 2015 and 2016, subscription and other revenue accounted for 18%, 16%, 20% and 17% of our total revenue, respectively.

For the three months ended September 30, 2016 compared to 2015, subscription and other revenue decreased \$0.8 million or 1%, primarily due to an agreement for which the term expired in December 2015, which was recorded in other revenue, offset by an increase in the average price per subscriber.

For the nine months ended September 30, 2016 compared to 2015, subscription and other revenue increased \$2.4 million or 1%, primarily due to an increase in the average price per subscriber, offset by an agreement for which the term expired in December 2015, which was recorded in other revenue.

Ticketing service

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

For the three and nine months ended September 30, 2016, ticketing service revenue was \$22.1 million and \$67.1 million and accounted for approximately 6% and 7% of our total revenue. In the three months ended September 30, 2016, Ticketfly had approximately 40 thousand live events on sale, for which approximately 3.9 million tickets, excluding box office sales, were sold to approximately 1.7 million unique ticket buyers, which resulted in more than \$155 million in gross transaction value, excluding box office sales. In the nine months ended September 30,

2016, Ticketfly had approximately 113 thousand live events on sale, for which approximately 11.4 million tickets, excluding box office sales, were sold to approximately 4.9 million unique ticket buyers, which resulted in more than \$485 million in gross transaction value, excluding box office sales. We had no ticketing service revenue in the three and nine months ended September 30, 2015, given that the acquisition of Ticketfly was completed on October 31, 2015.

Deferred revenue

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

Table of Contents

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

Costs and Expenses

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

Cost of revenue—Content acquisition costs

	Three months ended			Nine months ended		
	September 30,	September 30,	\$ Change	September 30,	September 30,	\$ Change
	2015	2016		2015	2016	
	(in thousands)			(in thousands)		
Cost of revenue - Content acquisition costs	\$ 211,272	\$ 174,334	\$(36,938)	\$ 467,429	\$ 522,231	\$ 54,802

Cost of revenue—content acquisition costs principally consist of royalties paid for streaming music or other content to our listeners. Content acquisition costs are currently calculated using negotiated rates documented in direct license agreements with major and independent record labels, music publishers and PROs. Prior to the launch of Pandora Plus on September 15, 2016, the majority of our content acquisition costs for sound recordings were based on a fee per public performance of a sound recording, and the majority of our content acquisition costs for the underlying musical works were based on a percentage of content acquisition costs paid for sound recordings. Subsequent to September 15, 2016, content acquisition costs for our ad-supported service are determined in the same way as described in the preceding sentence, though the fee per public performance of sound recordings is now determined by our direct licenses, rather than by the Web IV rate. The majority of the content acquisition costs for the sound recordings streamed on our subscription service are determined as the greater of a percentage of subscription revenue or a per subscriber minimum amount, subject to certain discounts, and the content acquisition costs for the underlying musical works are determined in the same manner as they were prior to September 15, 2016. Certain of our direct license agreements are also subject to minimum guarantee payments, some of which are paid in advance and amortized over the minimum guarantee period. For certain content acquisition arrangements, we accrue for estimated content acquisition costs based on the available facts and circumstances and adjust these estimates as more information becomes available.

For the three months ended September 30, 2016 compared to 2015, content acquisition costs decreased \$36.9 million or 17% and content acquisition costs as a percentage of total revenue decreased from 68% to 50%, primarily due to the one-time cumulative charges in the three months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty rate from June 2013 to September 2015. The decrease was offset by blended sound recording royalty rate increases of 15% related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs

due to the cost structure of our publishing licenses.

For the nine months ended September 30, 2016 compared to 2015, content acquisition costs increased \$54.8 million or 12% and content acquisition costs as a percentage of total revenue decreased from 56% to 53%, primarily due to the one-time cumulative charges in the three months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty rate from June 2013 to September 2015. The decrease was offset by blended sound recording royalty rate increases of 15% related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs due to the cost structure of our publishing licenses.

Cost of revenue—Other

Table of Contents

	Three months ended September 30, 2015			Nine months ended September 30, 2015		
	2015	2016	\$ Change	2015	2016	\$ Change
Cost of revenue — Other	\$21,414	\$25,556	\$ 4,142	\$57,690	\$71,388	\$ 13,698

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

For the three months ended September 30, 2016 compared to 2015, cost of revenue—other increased \$4.1 million or 19%, primarily due to a \$1.9 million increase in employee-related and facilities and equipment costs driven by an approximate 10% increase in headcount and a \$1.8 million increase in hosting and ad serving costs driven by an increase in advertising revenue.

For the nine months ended September 30, 2016 compared to 2015, cost of revenue—other increased \$13.7 million or 24%, primarily due to an \$7.7 million increase in employee-related and facilities and equipment costs driven by an approximate 10% increase in headcount, a \$4.4 million increase in hosting and ad serving costs driven by an increase in advertising revenue and a \$1.3 million increase in costs related to music events that are sold as part of advertising arrangements.

Cost of revenue - Ticketing service

	Three months ended September 30, 2016		Nine months ended September 30, 2016	
	2016	\$ Change	2016	\$ Change
Cost of revenue — Ticketing service	\$15,318	\$ 15,318	\$45,223	\$ 45,223

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

For the three months ended September 30, 2016, cost of revenue—ticketing service was \$15.3 million and consisted primarily of \$10.2 million in ticketing revenue share costs, \$3.3 million in credit card fees and other cost of revenue and \$1.4 million in intangible amortization expense. We had no cost of revenue—ticketing service in the three months ended September 30, 2015, given that the acquisition of Ticketfly was completed on October 31, 2015.

For the nine months ended September 30, 2016, cost of revenue—ticketing service was \$45.2 million and consisted primarily of \$30.3 million in ticketing revenue share costs, \$9.5 million in credit card fees and other cost of revenue and \$4.3 million in intangible amortization expense. We had no cost of revenue—ticketing service in the nine months

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

Gross profit

32

Table of Contents

	Three months ended September 30,			Nine months ended September 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
Gross profit						
Total revenue	\$311,562	\$351,901	\$40,339	\$827,886	\$992,228	\$164,342
Total cost of revenue	232,686	215,208	(17,478)	525,119	638,842	113,723
Gross profit	\$78,876	\$136,693	\$57,817	\$302,767	\$353,386	\$50,619
Gross margin	25	% 39	%	37	% 36	%

For the three months ended September 30, 2016 compared to 2015, gross profit increased by \$57.8 million or 73% and gross margin increased from 25% to 39% as the growth in revenue outpaced the growth in content acquisition costs, primarily due to the one-time cumulative charges in the three months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty rate from June 2013 to September 2015, offset by blended royalty rate increases of 15% related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs under the cost structure of our publishing licenses.

For the nine months ended September 30, 2016 compared to 2015, gross profit increased by \$50.6 million or 17% and gross margin decreased from 37% to 36% as the growth in revenue outpaced the growth in content acquisition costs, primarily due to the one-time cumulative charges in the nine months ended September 30, 2015 of \$57.9 million for the pre-1972 sound recordings settlement and \$23.9 million as a result of management's decision to forgo the application of the RMLC publisher royalty from June 2013 to September 2015, offset by blended royalty rate increases of 15% related to the Web IV rates set by the Copyright Royalty Board on December 16, 2015, an approximate 5% increase in listener hours and an increase in content acquisition costs paid to publishers and PROs under the cost structure of our publishing licenses.

Product development

	Three months ended September 30,			Nine months ended September 30,		
	2015	2016	\$ Change	2015	2016	\$ Change
	(in thousands)			(in thousands)		
Product development	\$21,849	\$33,657	\$11,808	\$56,466	\$103,311	\$46,845

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

For the three months ended September 30, 2016 compared to 2015, product development expense increased by \$11.8 million or 54%, primarily due to a \$15.0 million increase in employee-related and facilities and equipment costs driven by an approximate 65% increase in headcount and a \$1.6 million increase in intangible amortization expense, offset by a \$5.7 million increase in costs that we capitalized to develop software for internal use.

For the nine months ended September 30, 2016 compared to 2015, product development expenses increased \$46.8 million or 83%, primarily due to a \$55.3 million increase in employee-related and facilities and equipment costs driven by an approximate 65% increase in headcount, a \$5.2 million increase in intangible amortization expense and an increase of \$3.2 million in professional fees, offset by a \$17.0 million increase in costs that we capitalized to develop software for internal use.

Table of Contents*Sales and marketing*

	Three months ended			Nine months ended		
	September 30, 2015	2016	\$ Change	September 30, 2015	2016	\$ Change
	(in thousands)			(in thousands)		
Sales and marketing	\$ 107,286	\$ 116,475	\$ 9,189	\$ 285,595	\$ 357,909	\$ 72,314

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

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

For the three months ended September 30, 2016 compared to 2015, sales and marketing expenses increased \$9.2 million or 9%, primarily due to a \$15.4 million increase in employee-related and facilities and equipment costs driven by an approximate 20% increase in headcount and a \$1.7 million increase in intangible amortization expense, offset by a \$7.7 million decrease in brand marketing, advertising, direct response and search engine marketing costs driven by a decrease in advertising campaigns and a \$1.8 million decrease in transaction processing commissions on subscription purchases through mobile app stores due to reduced commission rates from our third-party subscription platform providers.

For the nine months ended September 30, 2016 compared to 2015, sales and marketing expenses increased \$72.3 million or 25%, primarily due to a \$47.9 million increase in employee-related and facilities and equipment costs driven by an approximate 20% increase in headcount, a \$15.2 million increase in brand marketing, advertising, direct response and search engine marketing costs driven by our advertising campaigns launched in the nine months ended September 30, 2016, a \$5.1 million increase in intangible amortization expense, a \$1.6 million increase in costs related to music events and a \$1.2 million increase in agency platform fees and media measurement.

General and administrative

	Three months ended			Nine months ended		
	September 30, 2015	2016	\$ Change	September 30, 2015	2016	\$ Change
	(in thousands)			(in thousands)		
General and administrative	\$ 35,603	\$ 41,768	\$ 6,165	\$ 111,169	\$ 128,626	\$ 17,457

General and administrative consists primarily of employee-related and facilities and equipment costs, including salaries, benefits and severance expense for finance, accounting, legal, internal information technology and other

administrative personnel. In addition, general and administrative expenses include professional services costs for outside legal and accounting services, infrastructure costs, credit card fees and sales and other tax expense. We expect general and administrative expenses to increase in future periods as we continue to invest in corporate infrastructure, including adding personnel and systems to our administrative functions.

For the three months ended September 30, 2016 compared to 2015, general and administrative expenses increased \$6.2 million or 17%, primarily due to an increase of \$7.1 million in employee-related and facilities and equipment costs driven by an approximate 25% increase in headcount, offset by a \$2.9 million decrease in professional fees related to content acquisition and other legal matters.

For the nine months ended September 30, 2016 compared to 2015, general and administrative expenses increased \$17.5 million or 16%, primarily due to a \$29.1 million increase in employee-related and facilities and equipment costs driven by

Table of Contents

executive severance and an approximate 25% increase in headcount and a \$2.5 million increase in sales and other tax expense, offset by a \$16.9 million decrease in professional fees related to content acquisition and other legal matters.

Interest expense

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

Provision for (benefit from) income taxes

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

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

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

Off-Balance Sheet Arrangements

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

Contractual Obligations

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

Quarterly Trends

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

Pandora

Our results reflect the effects of seasonal trends in listener and advertising behavior. We expect to experience both higher advertising sales due to greater advertiser demand during the holiday season and increased usage due to the popularity of holiday music during the last three months of each calendar year. In addition, we expect to experience lower advertising sales in the first three months of each calendar year due to reduced advertiser demand and increased

usage due to increased use of media-streaming devices received as gifts during the holiday season. We believe these seasonal trends have affected, and will continue to affect our operating results, particularly as increases in content acquisition costs from increased usage are not offset by increases in advertising sales in the first calendar quarter.

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

Ticketing Service

Table of Contents

Ticketfly's results reflect the effects of seasonality related to the timing of events. Tickets for festivals typically go on sale during the first half of the year. As such, the Ticketfly business has historically experienced an increase in revenue in the first half of each year relative to the fourth quarter of the prior year. We expect these seasonal trends to continue to affect our operating results.

Liquidity and Capital Resources

As of September 30, 2016, we had cash, cash equivalents and investments totaling \$264.0 million, which primarily consisted of cash and money market funds held at major financial institutions, commercial paper and investment-grade corporate debt securities.

Our principal uses of cash during the three and nine months ended September 30, 2016 were funding our operations, as described below, and capital expenditures.

Sources of Funds

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

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

Our Indebtedness

Credit Facility

We are party to a \$120.0 million credit facility with a syndicate of financial institutions, which expires on September 12, 2018. In September 2016, we borrowed \$90.0 million from the credit facility to enhance our working capital position. The amount borrowed is included in long-term debt on our balance sheet. Interest is payable quarterly at the applicable annual interest rate of 3.81% through September 2017. The applicable interest rate will be adjusted in September 2017.

As of September 30, 2016, we had \$1.2 million in letters of credit outstanding and \$28.8 million of available borrowing capacity under the credit facility. We are in compliance with all financial covenants associated with the credit facility as of September 30, 2016.

1.75% Convertible Senior Notes Due 2020

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

The Notes are unsecured, senior obligations of Pandora, and interest is payable semi-annually at a rate of 1.75% per annum. The Notes will mature on December 1, 2020, unless earlier repurchased or redeemed by Pandora or converted

in accordance with their terms prior to such date. Prior to July 1, 2020, the Notes are convertible at the option of holders only upon the occurrence of specified events or during certain periods thereafter, until the second scheduled trading day prior to maturity, the Notes will be convertible at the option of holders at any time.

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

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

Table of Contents

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

Capital Expenditures

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

Historical Trends

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

	Nine months ended September 30, 2015 2016 (in thousands)	
Net cash provided by (used in) operating activities	\$28,937	\$(179,073)
Net cash provided by (used in) investing activities	32,034	(43,755)
Net cash provided by financing activities	6,512	96,248

Operating activities

In the nine months ended September 30, 2016, net cash used in operating activities was \$179.1 million and primarily consisted of our net loss of \$253.0 million, which was partially offset by non-cash charges of \$164.1 million, primarily related to \$103.8 million in stock-based compensation charges and \$43.5 million in depreciation and amortization expense. Net cash used in operating activities also included an increase in prepaid content acquisition costs related to minimum guarantee payments of \$100.5 million and an increase in prepaid expenses and other assets of \$12.7 million, offset by an increase in deferred revenue of \$12.0 million and an increase in accrued compensation of \$10.4 million. Net cash used in operating activities increased by \$208.0 million from the nine months ended September 30, 2015, primarily due to an increase in our net loss of \$102.7 million and an increase in prepaid content acquisition costs of \$100.4 million.

Investing activities

In the nine months ended September 30, 2016, net cash used in investing activities was \$43.8 million and included \$46.4 million of capital expenditures for leasehold improvements and server equipment, \$22.3 million of capital expenditures for internal-use software and \$12.4 million in purchases of investments, offset by \$38.3 million in proceeds from sales and maturities of investments. Net cash used in investing activities increased by \$75.8 million from the nine months ended September 30, 2015, primarily due to a decrease in proceeds from sales and maturities of investments of \$182.8 million, an increase in capital expenditures for leasehold improvements and server equipment

of \$25.1 million and an increase in capital expenditures for internal-use software of \$16.3 million, offset by a decrease in purchases of investments of \$126.3 million.

Financing activities

In the nine months ended September 30, 2016, net cash provided by financing activities was \$96.2 million and included \$90.0 million in borrowings under debt arrangements, \$6.4 million in proceeds from our employee stock purchase plan and \$3.0 million in proceeds from the exercise of stock options, offset by \$3.1 million in tax payments from net share settlements of RSUs. Net cash provided by financing activities increased \$89.7 million from the nine months ended September 30, 2015, primarily due to borrowings under debt arrangements of \$90.0 million.

Table of Contents

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 Annual Report on Form 10-K for the year ended December 31, 2015 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies and Estimates."

Prepaid Content Acquisition Costs

Prepaid content acquisition costs are primarily comprised of minimum guarantees under content acquisition agreements. From November 2015 through September 2016, we signed direct license agreements for recorded music with major and independent labels, distributors and publishers. Certain of these license agreements include minimum guarantee payments, some of which are paid in advance. These minimum guarantees may take the form of either a contractually obligated minimum over a specified period of time that requires a true-up payment at the end of the specified period if the cumulative payments have not met or exceeded the specified minimum, or cash advance payments made at the beginning of, or at intervals during, the specified period, which cash payments are then recoupable against content acquisition costs over the specified period. On a quarterly basis, we record the greater of the cumulative actual content acquisition costs incurred or the cumulative minimum guarantee based on forecasted usage for the minimum guarantee period. The minimum guarantee period is the period of time that the minimum guarantee relates to, as specified in each agreement, which may be annual or a longer period. The cumulative minimum guarantee, based on forecasted usage considers factors such as listening hours, revenue, subscribers and other terms of each agreement that impact our expected attainment or recoupment of the minimum guarantees on a non-straight line basis. If we are unable to accurately estimate the forecasted usage for the minimum guarantee period, our content acquisition costs could increase and materially adversely affect our business, financial condition and results of operations.

Table of Contents

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Fluctuation Risk

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

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. Before deciding to invest in our common stock, you should carefully consider each of the risk factors described below, which include any material changes to, and supersede the description of, risk factors associated with the Company's business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015. The below risks, and other 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.

Risks Related to Our Business

Our ability to offer interactive features in our services depends upon maintaining commercially viable direct licenses with copyright owners of the music we play. If we are not able to maintain these direct licenses, we could lose the right to provide interactive features in our current services, or launch an on-demand music service. If we are not able to renew these direct licenses on similar terms when they expire, our profitability may be negatively affected.

Prior to September 15, 2016, we obtained the right to publicly perform music sound recordings on our services in the U.S. primarily through a statutory license at rates set by the Copyright Royalty Board. From November 2015 to September 2016, we entered into direct license agreements with dozens of music sound recording copyright owners, commonly known as "record labels", with thousands of musical work copyright owners, commonly known as "publishers", and with ASCAP, BMI and SESAC, the three largest performing rights organizations, commonly known as "PROs". In total, these agreements give us the right to add interactive features such as replays, additional skips and offline play to our current ad-supported and subscription radio services in the U.S., which features we introduced on September 15, 2016, and they also give us the right to launch an on-demand music service in the U.S., which we intend to do in the future. We continue to rely on the U.S. statutory license to publicly perform music sound recordings that are not covered by our direct licenses with record labels, but those recordings now constitute a small portion of the music that we stream. The direct licenses we have entered into with record labels and publishers are complex and require significant on-going efforts to operationalize, and there is risk that we may not be able to comply with the terms of these licenses, which could result in the loss of some or all of these licenses and some or all of the rights they convey. Similarly, many of these licenses provide that if the licensor loses rights in a portion of the content licensed under the agreement, that content may be removed from the license going-forward. In addition, if we are acquired, certain terms of our direct licenses, including favorable rates for content acquisition costs that currently apply to us, may not be available to an acquiror. If we were to fail to maintain any of these direct licenses, or if rights to certain music were no longer available under these licenses, then we may have to remove the affected music from our services, or discontinue certain interactive features for such music, or it might become commercially impractical for us to launch an on-demand music service. Any of these occurrences could have a material adverse effect on our business, financial condition and results of operations.

Several of these direct licenses also include so-called "most favored nations" provisions, which, if triggered, could cause our payments under those agreements to escalate substantially. In addition, record labels, publishers and PROs with whom we have entered into direct licenses have the right to audit our content acquisition payments, and any such audit could result in disputes over whether we have paid the proper content acquisition costs. If such a dispute were to occur, we could be required to pay additional content acquisition costs, audit fees and interest or penalties, and the amounts involved could materially and adversely affect our business, financial condition and results of operations. Pursuant to the statutory license under which we streamed most of our sound recordings prior to September 15, 2016, and under which we will stream a small portion of our sound recordings going forward, SoundExchange, Inc. ("SoundExchange") has the right to audit our content acquisition payments thereunder. SoundExchange is currently conducting audits of our payments for the years 2010 to 2014.

Further, there is no guarantee that the direct licenses we have now will be renewed in the future or that such licenses will be available at the rates for content acquisition costs associated with the current licenses. If we are unable to secure and maintain direct licenses for the rights to provide music on our services at rates that are similar to those under our current direct licenses, or other commercially viable rates, our content costs could rise and materially adversely affect our business, financial condition and results of operations.

Table of Contents

The rates we must pay for "mechanical rights" to use musical works on our services are set by the Copyright Royalty Board, which is currently in the process of determining these rates for the five-year period beginning January 1, 2018. If these rates increase significantly, it will adversely affect our business.

Our direct licenses with thousands of music publishers provide that the content acquisition payments for the so-called "mechanical rights"—which are implicated in the interactive features that we introduced on September 15, 2016 to our current ad-supported and subscription radio services, and will similarly apply to our forthcoming on-demand music service—are determined in accordance with the rate formula set by the Copyright Royalty Board for the compulsory license made available by Section 115 of the Copyright Act. Further, these rates are also applicable to our use of musical works for which we do not have a direct license with the copyright owners. The current rate structure for the Section 115 compulsory license expires at the end of 2017. The Copyright Royalty Board has commenced a proceeding to set the rates for the Section 115 compulsory license for calendar years 2018 to 2022 (the "115 Proceedings"), and we are a participant in the 115 Proceedings. The trial under this proceeding will begin in March 2017. The rates established by the Copyright Royalty Board in the 115 Proceedings may be higher, lower or the same as the rates currently in effect. If the 115 Proceedings yield rates that exceed the rates that are currently in place, our content acquisition costs may significantly increase, which could materially harm our financial condition and hinder our ability to provide interactive features in our services, or make an on-demand music service not economically viable.

If our efforts to attract and retain subscribers or convert ad-supported listeners into subscribers of our subscription offerings are not successful, our business will be adversely affected.

Our ability to continue to attract and retain users of our paid subscription services will depend in part on our ability to consistently provide our subscribers with a quality experience through Pandora Plus and our on-demand music service that we intend to launch. If Pandora Plus 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 or be able to convince listeners to become subscribers of such additional service offerings. 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 that provide a better value or experience or as a result in changes in pricing. Further, in a number of cases, the rates that we pay pursuant to our direct license agreements with record labels are significantly affected by the number of subscribers we are able to attract and retain. If our efforts to attract and retain subscribers are not successful, our business, operating results and financial condition may be adversely affected.

If we are unsuccessful at launching our on-demand subscription offering our business may be adversely affected.

Our acquisition of certain assets of Rdio in December 2015 was intended to facilitate our launch of new subscription offerings that provide additional functionality, including our Pandora Plus service, launched on September 15, 2016, and an on-demand offering. In addition to the cost of the Rdio assets, the development and launch of such additional service offerings has required and will continue to require significant engineering as well as marketing and other resources. In addition, to support the launch of these services we have entered into direct license agreements with the major record labels, which agreements entail substantial minimum guaranteed content acquisition cost payments by us. There is no assurance that we will be able to successfully develop and launch our on-demand subscription offering, obtain and maintain the content license rights to enable the offering of such services. Further, in a number of cases, our direct license agreements with record labels require that we launch an on-demand subscription service, and the rates for content acquisition costs payable under certain of our direct license agreements with record labels are significantly affected by the number of subscribers we are able to attract and retain to our subscription services, including our planned on-demand subscription service. If we fail to accomplish any of the foregoing and the

additional service offerings are unsuccessful, we will not realize the benefits of the Rdio asset acquisition or the substantial investment made in the development of such additional product offerings.

Our inability to obtain accurate and comprehensive information necessary to identify the ownership of sound recordings and musical works used on our services may impact our ability to perform our obligations under our licenses from the copyright holders, may require us to remove or decrease the number of performances of certain music on our services, and may subject us to potential copyright infringement claims and difficulties in controlling content acquisition costs.

We currently rely on the assistance of third parties to determine comprehensive and accurate rightsholder information for the sound recordings and the musical works underlying the sound recordings that we use on our services. If the information provided to us does not comprehensively or accurately identify which labels, artists, composers, songwriters or publishers own or administer sound recordings or musical works, or if we are unable to determine which musical works correspond to specific sound recordings, it may be difficult to identify the appropriate rightsholders to pay under our direct licenses, and it may also

Table of Contents

be difficult to comply with other obligations under those agreements. Further, our inability to accurately identify rights holders may prevent us from obtaining necessary additional licenses, which could lead to a reduction in the music available to stream on our service, adversely impacting our ability to retain and expand our listener base. Such a lack of ownership data may also make it difficult to identify the sound recordings that we should remove from our service, which may subject us to significant liability for copyright infringement.

We also rely on the assistance of third parties to provide notices of intent ("NOIs") for a compulsory license under Section 115 of the Copyright Act to those copyright owners with whom we do not have a direct license agreement or whose contact information is unavailable or unknown. If the third parties on which we rely do not provide NOIs to the correct parties (including the United States Copyright Office for unknown copyright owners), or to all parties who should receive an NOI, or do not serve the NOI in a timely manner, we may be subject to significant liability for copyright infringement.

Minimum guarantees required under certain of our music license agreements may limit our operating flexibility and could adversely affect our liquidity and results of operations.

As described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Note 5, Commitments and Contingencies", certain of our music license agreements contain minimum guarantees and require that we make upfront minimum guarantee payments. As of September 30, 2016, we have future minimum guarantee commitments of \$780.1 million. Such minimum guarantees related to our content acquisition costs are not tied to our number of subscribers, active users or the number of sound recordings used on our services. As such, our ability to achieve and sustain profitability and operating leverage on our services depends on our ability to increase our revenue through increased paid subscriptions and advertising sales on terms that maintain an adequate gross margin. Given the multiple-year duration and largely fixed cost nature of these minimum guarantees, if subscriber acquisition and retention or advertising sales do not meet our expectations, our margins may be materially and adversely affected. To the extent subscriber and subscription revenue growth or advertising sales do not meet our expectations, our liquidity and results of operations could also be adversely affected as a result of such minimum guarantees. In addition, the long-term and fixed cost nature of these minimum guarantees may limit our flexibility in planning for, or reacting to, changes in our business and the market segments in which we operate.

We rely on estimates of the market share of licenseable content controlled by each content provider to forecast whether such minimum guarantees will be recoupable against our actual content acquisition costs incurred over the duration of the license agreement. To the extent that these market share estimates are incorrect and our actual content acquisition costs for a particular content provider is less than the amount of the minimum guarantee, our margins may be materially and adversely affected.

We are not able to obtain licenses for the underlying literary works for the sound recordings of spoken-word comedy content that we stream. Third parties could assert copyright claims against us as a result.

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 content acquisition costs 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 claims of copyright infringement.

If we are unable to maintain revenue growth from our advertising products, particularly in mobile advertising, our results of operations will be materially adversely affected.

Our number of listener hours on mobile devices comprised approximately 86% of our total listener hours for the nine months ended September 30, 2016, and we expect that mobile listener hours will continue to grow more quickly than computer listener hours. The percentage of advertising spending allocated to digital advertising on mobile devices still lags behind that allocated to traditional online advertising. According to eMarketer, the percentage of U.S. advertising spending allocated to advertising on mobile devices was approximately 23% in 2016, compared to approximately 37% for all online advertising. We must therefore continue to 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 continue to build our sales capability to penetrate local advertising markets, which we view as a key challenge to monetizing our listener hours, including listener hours on mobile and other connected devices. Our audio advertising capability also places us in direct competition with terrestrial radio, as many advertisers that purchase audio ads focus their spending on

Table of Contents

terrestrial radio stations who traditionally have strong connections with local advertisers. We cannot foresee whether we will be able to continue to capture local and audio advertising revenue at the current rate of growth, which may have an adverse impact on future revenue and income.

We continue to work on initiatives 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 may not be able to effectively monetize inventory generated by listeners using mobile and connected devices, or do so in a time frame that supports our business plans.

Advertising spending is increasingly being placed through new data-driven channels, such as the programmatic buying ecosystem, where mobile offerings are not as mature as their web-based equivalents. Because the substantial majority of our listener hours occur on mobile devices, our growth prospects and revenue may be adversely affected if the advertising ecosystem is slow to adopt data-driven mobile advertising offerings.

As new advertising buying technologies, such as programmatic buying, develop around data-driven technologies and advertising products, an increasing percentage of advertising spend is likely to shift to such channels and products. These data-driven advertising products and programmatic buying technologies allow publishers to use data to target advertising toward specific groups of consumers who are more likely to be interested in the advertising message delivered. These advertising products and programmatic technologies are currently more developed in terms of ad technology and industry adoption on the web than they are on mobile. Due to the fact that the substantial majority of our listener hours occur on mobile devices, our ability to attract advertising spend, and ultimately our ad revenue, may be adversely affected by this shift. We have no reliable way to predict how significantly or how quickly advertisers will shift buying to programmatic technologies and data-driven advertising products.

We have developed a data-driven, programmatic advertising capability for mobile in an effort to take advantage of this trend. However, we only released this capability to the market in the second quarter of 2015, and we have no reliable way to predict how significantly or how quickly advertisers will shift buying toward such data-driven ad products and programmatic channels on mobile. If advertising spend continues to be reallocated to web-based programmatic technologies and mobile programmatic adoption lags, our ability to grow revenue may be adversely affected.

Emerging industry trends in digital advertising measurement and pricing may pose challenges for our ability to forecast and optimize our advertising inventory which may adversely impact our advertising revenue.

The digital advertising marketplace is introducing new ways to measure and price advertising inventory. Specifically, the Media Ratings Council released the Viewable Ad Impression Measurement Guidelines in 2014 pursuant to which web display and web video advertising inventory will be transacted upon based on the number of "viewable" impressions delivered in connection with an applicable advertising campaign (instead of the number of ads served by the applicable ad server). The industry is in the early stages of this transition and we are still determining its potential impact on our inventory, operational resources, pricing, and revenue. In addition, the current measurement solutions are limited to web display and web video inventory and do not include mobile and audio inventory. Nonetheless, advertisers have been aggressively pushing to transact advertising purchases for audio advertising and mobile placement on a measured "viewable" basis. As these trends in the industry continue to evolve, our advertising revenue may be adversely affected by the availability, accuracy and utility of the available analytics and measurement technologies.

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

For the nine months ended September 30, 2016, we derived 77% 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, particularly within desired demographics;
- keeping pace with changes in technology and our competitors;
- competing effectively for advertising dollars from other online marketing and media companies;

Table of Contents

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 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 industry 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.

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 certain of their measurements have earned Media Ratings Council accreditation, 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 supplement third-party measurement data with our internal research, which may be perceived as less valuable than third-party numbers. If third-party measurement providers report lower metrics than we do, or if there is wide variance among reported metrics, our ability to attract advertisers to 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.

We have invested substantial resources to create accurate cross-platform measurements for internet radio and broadcast radio in the major automated media-buying platforms, attempting to create a one-stop shop that enables media buyers to compare internet radio audience reach with terrestrial radio audience reach using traditional broadcast

radio metrics.

Media buying agencies 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 agencies may choose not to show, or may be prohibited by contract from showing, internet radio metrics alongside traditional terrestrial metrics. Despite our efforts to achieve parity within the tools available to media buying agencies, a lack of comparable internet radio metrics in these buying tools could have a materially negative effect on our ability to sell advertising on our service and achieve our revenue goals.

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

45

Table of Contents

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.

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 both Pandora-developed and third-party developed apps that hardware manufacturers embed in, and distribute through, their devices. Most of our agreements with makers of mobile operating systems and devices through which our service may be accessed, including Apple, Google and Microsoft, are short-term or can be canceled 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 and operating system providers, including Apple, Amazon, Samsung and Google, 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.

Connected devices and their underlying technologies 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 challenging to keep pace with the continual release of new devices and technological advances in digital media delivery. If manufacturers fail to make products that are interoperable with our technology or we fail to adapt our technology to their 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.

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. Some of these challenges include:

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

• successfully expanding our share of listening in cars;

• continuing to build and maintain availability of catalogs of music and comedy and other 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 and other consumer electronic products to make our service available through their products;

46

Table of Contents

- maintaining positive listener perception of our service while managing ad-load to optimize inventory utilization; and
- minimizing listener churn and attracting lapsed listeners back to the service.

In addition, we have historically relied heavily on the success of viral marketing to expand consumer awareness of our service. We recently began supplementing our viral marketing strategy with larger, more costly marketing campaigns, and this increase in marketing expenses could fail to achieve expected returns and therefore have an adverse effect on our results of operations. We cannot guarantee that we will be successful in maintaining or expanding our listener base and failure to do so would materially and adversely affect our business, operating results and financial condition.

Further, although we use our number of active users as a key indicator of our brand awareness and the growth of our business, the number of active users exceeds the number of unique individuals who register for, or actively use, our service. We define active users as the number of distinct 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.

If we fail to accurately predict and play music, comedy or other 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 guarantee that such investments will produce the intended results. 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 over 1,000,000 analyzed songs in our library, 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, and for that content we also try 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 and other content to an even greater extent, particularly as we lack experience with content other than music, do not yet have as large a data set on listener preferences for comedy and other content, and have a much smaller catalog as compared to music. Our ability to predict and select music, comedy and other 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.

We face, and will continue to face, competition with other content providers for listener hours and advertising spending.

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. Such competition affects the amount of quality advertising inventory available which we can offer to advertisers on our ad-supported service.

Many of our competitors may leverage their existing infrastructure, brand recognition and content collections to augment their services by offering competing internet radio features within a more comprehensive digital music streaming service. We face increasing competition for listeners from a growing variety of music services that deliver music content through mobile phones and other wireless devices. Our direct competitors in the internet radio segment include iHeart Radio, iTunes Radio, Beats 1 Radio, LastFM and other companies in the traditional broadcast and internet radio market. We also directly compete with the non-interactive, Internet radio offerings provided by digital music streaming services such as Spotify, Google Play Music and Slacker, and we compete more broadly with the interactive music services offered by these companies and others, such as Apple Music, YouTube and Amazon Music Unlimited.

Table of Contents

Our competitors also include terrestrial radio and satellite radio services, many of which also broadcast on the internet. 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 content acquisition costs for its use of sound recordings and satellite radio pays a much lower percentage of revenue, 10% in 2015 and 10.5% in 2016, 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.

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 also compete with many other forms of media and services for the time and attention of our listeners, including non-music competitors such as Facebook, Google, MSN, Yahoo!, ABC, CBS, FOX, NBC, The New York Times and the Wall Street Journal, among others.

We believe that companies with a combination of financial resources, technical expertise and digital media experience also pose a significant threat. For example, Apple, Amazon and Google have recently launched competing services. These and other competitors may devote greater resources than we have available, have a more accelerated time frame for deployment, be willing to absorb significant costs to acquire customers through free trials or other initiatives, operate their music services at a loss in order to drive their other profitable businesses, and leverage their existing user base and proprietary technologies to provide products and services that our listeners and advertisers may view as superior or more cost effective. Our current and future competitors may have more well established brand recognition, more established relationships with music content 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 the presence and visibility of our app, which is distributed via the largest app stores operated by Apple, Google, Amazon and Microsoft. Such distribution is subject to an application developer license agreement in each case. We face significant competition for listeners from these companies, who are also promoting their own digital music and content online through their app stores. Search engines and app 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, app 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 app 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 app stores and in consumer electronics products and automobiles, our listener hours may fail to increase as expected or decline and our business may suffer. Additionally, should any of these parties reject our app from their app store or amend the terms of their license in such a way that inhibits our ability to distribute our apps, or negatively affects 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.

To compete effectively, we must continue to invest significant resources in the development of our service to enhance the user experience of our listeners.

Additionally, 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. There can be no assurance that we will be able to compete successfully for listeners and advertisers in the future against existing or new competitors, and failure to do so could result in loss of existing or potential listeners, 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, diminish our brand strength and prevent us from achieving or maintaining profitability.

Table of Contents

If we are not successful in operating and growing our recently acquired Ticketfly business, we will not realize the benefits anticipated when we acquired the business.

We acquired Ticketfly in October 2015, which was our first major acquisition and represents an entirely new line of business for us. Ticketfly's business is highly sensitive to rapidly changing public tastes and is dependent on the availability of popular artists and events. Ticketfly's revenue is derived from ticketing services under client contracts with venues and event promoters across North America, which consist primarily of per ticket convenience fees, credit card processing and shipping fees as well as per order "order processing" fees. If Ticketfly's clients fail to anticipate the tastes of consumers and to offer events that appeal to them, the business may not grow or succeed. We cannot provide assurances that Ticketfly will be able to maintain or expand arrangements with clients and other third parties on acceptable terms, if at all. Furthermore, a decline in attendance at or reduction in the number of live entertainment, sporting and leisure events for any reason may have an adverse effect on our Ticketfly business. If we fail to successfully operate and grow our Ticketfly business, we will not realize the benefits anticipated when we acquired the business, and any such failure could result in substantial impairment charges.

Our ability to expand our services into countries outside the United States is dependent on our ability to obtain necessary licenses from content owners, which we currently do not have.

We currently operate our services in the United States, Australia and New Zealand. In Australia and New Zealand, we have licenses from copyright owners to provide our ad-supported and subscription radio services without the additional interactive features that we introduced in the U.S. on September 15, 2016, and we do not yet have the necessary licenses from copyright owners to launch an on-demand music service in Australia or New Zealand. Therefore, in order to introduce interactive features into our existing services in Australia and New Zealand, or to launch an on-demand music service there, or to launch any interactive or non-interactive music streaming service anywhere else in the world, we will need to negotiate and execute license agreements with the necessary rights holders. We may not be able to obtain all of the necessary rights to expand our service offerings on commercially viable terms, or at all. If we are not able to obtain the necessary licenses on commercially viable terms, then we will not be able to proceed with our international service expansion plans, and our growth could suffer materially. This could adversely affect our business, financial condition and results of operations.

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

Expanding our operations into international markets is an element of our long-term strategy. For example, in June 2012 we began providing our service 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 direct licenses from rights organizations and other content owners may not be available on commercially viable terms. Addressing licensing structure and issues with the rate for content acquisition costs 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 market our service in non-English speaking countries;

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

the need to conform our operations, and 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;

Table of Contents

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.

Expansion of our operations into content beyond pre-recorded music, including comedy, live events and podcasts, subjects us to additional business, legal, financial and competitive risks.

Expansion of our operations into delivery of content beyond pre-recorded music involves numerous risks and challenges, including increased capital requirements, new competitors and the need to develop new strategic relationships. Growth into these new areas 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 additional expertise that we currently do not have. There is no guarantee that we will be able to generate sufficient revenue from advertising sales associated with comedy, live events, podcasts or other non-prerecorded-music content to offset the costs of maintaining these stations or the content acquisition costs paid for such stations. Further, we have established a reputation as a music format internet radio provider and our ability to gain acceptance and listenership for comedy, live events, podcasts or other non-music content stations, and thus our ability to attract advertisers on these stations, is not certain. Failure to obtain or retain rights to comedy, live events, podcasts or other non-music 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 business and financial condition.

We have acquired, and may continue to 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 have recently acquired and 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. For example, in 2015, we acquired Next Big Sound, Ticketfly and certain assets of Rdio. These acquisitions, and our pursuit of future 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 and integrating other businesses. We may be unsuccessful in integrating our recently acquired businesses or any additional business we may acquire in the future. For instance, our acquisition in December 2015 of certain assets of Rdio in order to facilitate our intention to launch an on-demand service, will require time and resources. There is no assurance that we will be able to successfully launch an on-demand service, if at all, and if we fail to launch an on-demand service or a new service is unsuccessful,

we will not realize the benefits of this acquisition.

We also may not achieve the anticipated benefits from any 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;

Table of Contents

- 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.

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 hours, through other platforms and partners over time, including through direct integration into connected cars. However, product design cycles in automotive manufacturing are lengthy and the useful lives of automobiles in service is long, and we may not be able to achieve our goals in our desired timeframe, which could adversely impact our ability to grow our business.

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.

We rely upon an agreement with DoubleClick, which is owned by Google, for delivering and monitoring most of 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 most of the 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.

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 apps and service offerings and expect to continue to do so. The operation of our apps 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

Table of Contents

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.

Digital music streaming is an evolving industry, which makes it difficult to evaluate our near- and long-term business prospects.

Digital music streaming continues to develop as an industry and our near- and long-term business prospects are difficult to evaluate. The marketplace for digital music streaming is subject to significant challenges and new competitors. As a result, the future revenue, income and growth potential of our business is uncertain. Investors should consider our business and prospects in light of the risks and difficulties we encounter in this evolving business, which risks and difficulties include, among others, risks related to:

- our evolving business model and new licensing models for content as well as the potential need for additional types of content;

- our ability to develop additional products and services, or products and services in adjacent markets, in order to maintain revenue growth, and the resource requirements of doing so;

- our ability to retain current levels of active listeners, build our listener base and increase listener hours;

- our ability to effectively monetize listener hours by growing our sales of advertising inventory created from developing new and compelling ad product solutions that successfully deliver advertisers' messages across the range of our delivery platforms while maintaining our listener experience;

- 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 platform providers, makers of mobile devices, consumer electronic products and automobiles;

- 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 an evolving marketplace could materially and adversely affect our business, financial condition and results of operations.

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 September 30, 2016, we had an accumulated deficit of \$619.6 million. A key element of our strategy is to increase the number of listeners and listener hours to increase our industry 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. This strategy includes recently completed acquisitions and other initiatives. 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, or new revenue sources, to offset our expenses. In addition, we plan to continue to invest heavily in our operations to support anticipated future growth. As a result of these factors, we expect to incur annual net losses in the near term.

Our revenue has increased rapidly in recent periods; 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 guarantee that our revenue will continue to grow or will not decline. Investors 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 material adverse 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.

Table of Contents

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 and enhance our reporting systems and procedures. 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.

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

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

Our brands 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, or if we partner with manufacturers of products that our listeners reject, the strength of our brand could be adversely affected.

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.

Federal copyright protection does not apply to sound recordings created prior to February 15, 1972 ("pre-1972 sound recordings"). The protection of such recordings is instead governed by a patchwork of state statutory and common laws. Copyright owners of pre-1972 sound recordings have commenced litigation against us in New York, California, Illinois, and New Jersey alleging violations of state statutory and common laws arising from the reproduction and public performance of pre-1972 sound recordings. Despite settling one such suit with the major record labels in October 2015, and entering into direct license agreements for recorded music with major and independent labels, distributors and publishers during the first nine months of 2016 that also permit us to stream certain pre-1972 sound recordings, we still face a number of class-action suits brought by various plaintiffs who seek, 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.

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. Similarly, any settlements of the remaining litigation could require substantial payments. 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 recordings 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.

We could be adversely affected by regulatory restrictions on the use of mobile and other electronic devices in motor vehicles and legal claims arising 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 voluntary Phase 1

Table of Contents

Driver Distraction Guidelines for visual-manual devices not related to the driving task that are integrated into motor vehicles. In March 2014, NHTSA held a public meeting soliciting comments related to its voluntary Phase 2 Driver Distraction Guidelines for portable and aftermarket devices that may be used in motor vehicles, but such guidelines have not yet been issued. If NHTSA or other agencies implemented regulatory restrictions and took enforcement action related to how drivers and passengers in motor vehicles may engage with devices on which our service is broadcast, such restrictions or enforcement actions 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 used to access our service in motor vehicles could result in product liability or personal injury litigation and negative publicity.

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 from and about our listeners and artists as they interact with our service, including information which could fall under a definition of "personally identifiable information" under various state and federal laws. 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, such as Pandora One or Ticketfly. 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. We also collect information from and track artists' activity on our Pandora Artist Marketing Platform. Third parties may, either without our knowledge or consent, or in violation of contractual prohibitions, obtain, transmit or utilize our listeners' or artists' personally identifiable information, or data associated with particular users, devices or artists.

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 authorities 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.

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, could 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.

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

Table of Contents

We are subject to general business regulations and laws, as well as regulations and laws specific to the internet. Such laws and regulations cover sales and other taxes and withholding of taxes, 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 network 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.

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 due to 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:

- costs associated with pursuing licenses or other commercial arrangements;

- costs associated with defending any litigation, including intellectual property infringement litigation, and any associated judgments or settlements;

- our ability to pursue, and the timing of, entry into new geographic or content markets or other strategic initiatives and, if pursued, our management of these initiatives;

- the impact of general economic and competitive 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 year due to greater advertiser demand during the holiday season and lower advertising sales in the first quarter of the following year. 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 year due to the holiday season, and in the first quarter of each year due to increased use of media-streaming devices received as gifts during the holiday season.

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 September 30, 2016, as indicated in "Controls and Procedures-Evaluation of Disclosure Controls and Procedures", we must continue to monitor and assess our internal control over financial reporting. Additionally, we must implement internal control over the financial reporting of Ticketfly, our subsidiary, that complies with Section 404 of the Sarbanes-Oxley Act of 2002 by the end of 2016. Any material weaknesses in Ticketfly's internal control over financial reporting that remain uncorrected at year-end must be identified in our management's report on our internal controls 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 that such internal control is effective at year-end. If we are unable to assert that our internal control

Table of Contents

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 the price of our common stock.

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, 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.

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. To establish and protect those proprietary rights, we rely on a combination of patents, patent applications, trademarks, copyrights, trade secrets (including know-how), license agreements, information security procedures, non-disclosure agreements with third parties, employee disclosure and invention assignment agreements, and other contractual obligations. These afford only limited protection. Despite our efforts to protect our intellectual property rights, unauthorized parties may copy or attempt to copy aspects of our technology. 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 from time to time we have purchased patents and patent applications from third parties. 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. Moreover, in certain circumstances there are additional risks, including:

- present or future patents or other intellectual property rights could lapse or be invalidated, circumvented, challenged or abandoned;

- our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes may be limited by our relationships with third parties;

- our pending or future patent applications may not have coverage sufficient to provide the desired competitive advantage; and

our intellectual property rights may not be enforced in jurisdictions where competition may be intense or where legal protection may be weak.

We have registered "Pandora," "Music Genome Project", "Next Big Sound", "Ticketfly" and other marks as trademarks in the United States and other countries. Nevertheless, competitors may adopt service names similar to ours, or purchase 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.

Table of Contents

We currently own the www.pandora.com and www.ticketfly.com internet domain names and various other domain names related to our business. The regulation of domain names in the United States and in foreign countries is subject to change. Regulatory bodies continue to establish additional top-level domains, appoint additional domain name registrars and 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. If we lose or fail to acquire the right to use any domain name relevant to our current or future business in the United States or other countries, we may incur significant additional expense.

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 the same subject matter as that covered by 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' independent development of technology similar to ours for which we are unable to rely on other forms of intellectual property protection such as patents, could adversely affect our competitive business position.

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

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

Internet, technology and media companies are frequently subject to litigation based on allegations of infringement, misappropriation or other violations of others' 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 third parties to submit content for our catalog and we cannot be assured that artist representations made in connection with such submissions accurately reflect the legal rights of the submitted 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 guarantee 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. When 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 adjudicated 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 products or services that are alleged to infringe or misappropriate the intellectual

property of others; expend additional development resources to redesign our services to avoid infringement; enter into potentially unfavorable content acquisition or license agreements in order to obtain the right to use necessary technologies, content or materials; or to indemnify our partners and other third parties. We do not carry broadly applicable patent liability insurance and lawsuits regarding patent rights, regardless of their success, can be expensive to resolve and can divert the time and attention of our management and technical personnel.

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. Such open source licenses often 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

Table of Contents

some uncertainty. We rely on multiple employee and non-employee software programmers to design our proprietary technologies, and since we may not be able to exercise complete control over the development efforts of all such programmers we cannot be certain that they have not incorporated open source software into our products and services without our knowledge, 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 may be required to publicly release the affected portions of our source code, be forced to re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce the value of our services and technologies and materially and adversely affect our ability to sustain and grow our business.

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 at our own premises and at those of third-party vendors, including network service providers and data center facilities, to enable listeners to stream our content in a dependable 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. In the event of a service outage at our main site, we maintain a backup site that can function in read-only capacity. We do not currently maintain live fail-over capability that would allow us to instantaneously switch our streaming operations from one facility to another in the event of a service outage. In the event of an extended service outage at our main site, we do maintain and test fail-over capabilities that should allow us to switch our live streaming operations from one facility to another. 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, hacking, denial of service attacks, sabotage, intentional acts of vandalism, 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 do not exercise complete 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.

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 and retain listeners and advertisers.

Techniques used to gain unauthorized access to corporate data systems 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 malware, Trojans, viruses, worms, break-ins, phishing attacks, denial-of-service attacks, attempts to access our servers to acquire playlists or stream music in an unauthorized manner, or other attacks on and disruptions 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 on our systems or a vendor's systems, we may face civil liability and reputational damage, either of which would negatively affect our ability to attract and retain 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 content acquisition cost obligations with no corresponding revenue.

We may not be able to effectively control the unauthorized actions of third parties who may have access to the listener data we collect. The integration of the Pandora service with apps 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 opportunities.

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

Table of Contents

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

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

We accept subscription payments 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 absorb 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 accredited against, and in compliance with, the Payment Card Industry Data Security Standard, or PCI DSS, the payment card industry's security standard for companies that collect, store or transmit certain data regarding credit and debit cards, credit and debit card holders and credit and debit card transactions. Currently we comply with PCI DSS version 3.2 as a Level 2 merchant. Ticketfly is a Level 2 merchant and has been given an extension until January 2017 to recertify that they are in compliance with PCI DSS. There is no guarantee that Pandora or Ticketfly 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.

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

At December 31, 2015, we had federal net operating loss carryforwards of approximately \$613.0 million and tax credit carryforwards of approximately \$9.7 million. At December 31, 2015, we had state net operating loss carryforwards of approximately \$480.0 million and tax credit carryforwards of approximately of \$15.6 million. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, ("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 other 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 may be subject to limitations.

We could be subject to additional income tax liabilities.

We are subject to income taxes in the United States and in certain foreign jurisdictions. As we expand our operations globally, we become subject to taxation based on the applicable foreign statutory rates and our effective tax rate could fluctuate accordingly. Significant judgment is required in evaluating and estimating our worldwide provision for income taxes and

Table of Contents

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.

Our Ticketfly business and venue partners may be subject to sales tax and other taxes.

The application of indirect taxes (such as sales, use, excise, admissions, amusement, entertainment or other transaction-based taxes) to internet-based live entertainment ticketing businesses such as Ticketfly is a complex and evolving area. Many of the fundamental statutes and regulations that impose these taxes were established before the adoption and growth of the internet and ecommerce. In many cases, it is not clear how existing statutes apply to the internet or ecommerce. In addition, governments are increasingly looking for ways to increase revenues, which has resulted in discussions about tax reform and other legislative action to increase tax revenues, including through indirect taxes. Changes in these tax laws could adversely affect our business.

Ticketfly is not the seller of tickets sold on the Ticketfly platform. Instead it facilitates the transaction between our venue partners and customers. If a taxing jurisdiction were to treat Ticketfly as the seller and liable for the tax of the venue partners or customers, it could result in a material liability.

Ticketfly does not currently calculate all applicable indirect taxes on the fees charged when a customer purchases tickets on the Ticketfly platform. Some jurisdictions may interpret their law in a manner that would require Ticketfly to calculate, collect and remit the applicable indirect taxes on the entire charges. Such an interpretation could negatively impact our customers and our business.

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 success depends on the contributions of our executive officers as well as our ability to attract and retain qualified 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 in the San Francisco Bay Area, where our headquarters is located, and in New York, and we may incur significant costs to attract them. 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. We use share-based and other performance-based incentive awards such as restricted stock units and cash bonuses to help attract, retain, and motivate qualified individuals. If our share-based or other compensation programs cease to be viewed as competitive and valuable benefits, our ability to attract, retain, and motivate employees could be weakened, and our business could be harmed.

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.

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 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

Table of Contents

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 cybersecurity incidents 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 effect 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, cybersecurity incidents and similar disruptions caused by unauthorized tampering with our computer systems, which could lead to interruptions, delays, loss of critical data or the unauthorized disclosure of confidential customer data. Our business interruption insurance may be insufficient to compensate us for all such losses. As we rely heavily on our servers 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, resulting in a loss of existing or potential listeners and advertisers and increased maintenance costs, which would adversely affect our operating results and financial condition.

We may not have sufficient cash flow from our business to make payments on our indebtedness.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including our 1.75% convertible senior notes due 2020 (the "Notes"), depends on our performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. See "Note 7-Debt Instruments-Convertible Debt Offering." If one or more holders elect to convert their Notes, we may elect to satisfy our conversion obligation in whole or in part through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

Accounting Standards Codification Subtopic 470-20 (ASC 470-20), Debt with Conversion and Other Options, requires an entity to separately account for the liability and equity components of convertible debt instruments (such

as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component of the Notes is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to recognize a greater amount of non-cash interest expense current and future periods presented as a result of the amortization of the discounted carrying value of the Notes to their principal amount over the term of the Notes. We will report lower net income (or greater net losses) in our consolidated financial results because ASC 470-20 will require interest to include both the current period's amortization of the original issue discount and the instrument's coupon interest, which could adversely affect our reported or future consolidated financial results, the trading price of our common stock and the trading price of the Notes.

In addition, under certain circumstances, in calculating earnings per share, convertible debt instruments (such as the Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares of common stock issuable upon conversion of the Notes, if any, are not included in the calculation of

Table of Contents

diluted earnings per share except to the extent that the conversion value of the Notes exceeds their principal amount. Under the treasury stock method, diluted earnings per share is calculated as if the number of shares of common stock that would be necessary to settle such excess, if we were to elect to settle such excess in shares, were issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Notes (if any) then, to the extent we generate positive net income, our diluted consolidated earnings per share would be adversely affected.

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 Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2015, additional 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;
- our ability to grow active users and listener hours;
- competitive conditions and developments;
- our actual or anticipated achievement of financial and non-financial key operating metrics;
- general economic conditions and their impact on advertising spending;
- the overall performance of the equity markets;
- threatened or actual litigation or regulatory proceedings, including the recently concluded rate proceedings in the CRB;
- 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 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 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 about our business, 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.

Table of Contents

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 who are not nominated by the current members of our board of directors or take other corporate actions, including effecting changes in our management. These provisions include:

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

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

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

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

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

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

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

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

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

Section 203 of the Delaware General Corporation Law governs us. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time.

In addition, if we are acquired, certain terms of our music licensing arrangements, including favorable rates for content acquisition costs 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.

Table of Contents**Item 6. Exhibits**

Exhibit No.	Exhibit Description	Incorporated by Reference			Filing Date	Filed By	Filed Herewith
		Form	File No.	Exhibit			
3.01	Amended and Restated Certificate of Incorporation	S-1/A	333-172215	3.1	4/4/2011		
3.02	Certificate of Amendment to the Amended and Restated Certificate of Incorporation	10-Q	001-35198	3.02	7/26/2016		
3.03	Amended and Restated Bylaws	S-1/A	333-172215	3.2	4/4/2011		
3.04	Certificate of Amendment to the Amended and Restated Bylaws	10-Q	001-35198	3.04	7/26/2016		
31.01	Certification of the Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002						X
31.02	Certification of the Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002						X
32.01	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to 8 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002						X
101. INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document						X
101. SCH	XBRL Taxonomy Schema Linkbase Document						X
101.CAL	XBRL Taxonomy Calculation Linkbase Document						X
101.DEF	XBRL Taxonomy Definition Linkbase Document						X
101.LAB	XBRL Taxonomy Labels Linkbase Document						X
101.PRE	XBRL Taxonomy Presentation Linkbase Document						X

† Indicates management contract or compensatory plan.

Table of Contents

SIGNATURES

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

PANDORA MEDIA, INC.

Date: October 27, 2016 By: /s/ Michael S. Herring

Michael S. Herring

President and Chief Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)