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Scripts for:

Dominic Paschel, Vice President, Pandora

Roger Lynch, President & CEO, Pandora

Naveen Chopra, CFO, Pandora

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<u>Dominic Paschel</u>

Good afternoon, and welcome to Pandora's third quarter 2017 financial results call. Before we begin, let me remind everyone that today’s discussion will contain forward-looking statements based on our current assumptions, expectations and beliefs, including projected financial results or operating metrics, business strategies, anticipated future products or services, anticipated market demand or opportunities and other forward-looking topics. For a discussion of the specific risk factors that could cause our actual results to differ materially from today's discussion, please refer to the documents we file with the Securities and Exchange Commission.

Also, during this call, we will discuss non-GAAP measures of our performance. GAAP financial reconciliations and supplemental financial information are provided in the press release filed today with the SEC, and detailed financials are available on our Investor Relations site.

Today's call is available via webcast and a replay will be available for two weeks. We will also post the full text of today’s prepared remarks once they have been concluded. You can find all of the information I have just described on the Investor Relations section of Pandora.com. On today's call joining me are Roger Lynch, Pandora's new President & CEO, and Naveen Chopra, Pandora's Chief Financial Officer. With that, let me turn the call over to Roger, welcome Roger.

Roger Lynch

Introduction

Thanks, Dom, and thank you everyone for joining today’s call. I’m excited to be with you for my first earnings call with Pandora.

Vision

Pandora has made significant changes in its leadership in recent months, and I’m sure you're eagerly awaiting an update on our vision and strategy. Today I will be sharing some preliminary insights with more to come in early 2018.

In my six weeks as CEO, I've had the opportunity to meet with many stakeholders across our business - from advertisers, to label partners, technology partners, and of course, our employees across the country. And each of these conversations have helped shape my early vision for the company and our course ahead.

First and foremost, I believe everything we do needs to start with the customers we serve. At Pandora, these customers include both our listeners and our advertisers. We strive to be an irreplaceable and integral part of our listeners' everyday lives and our advertisers’ evolving marketing needs.

For listeners, that means being able to find the content they want, and also discovering new content-- on any connected device and in any setting they desire. And for advertisers, it means being able to transact with us in the way *they* desire… with the ability to target, verify and measure the success of their campaigns, and to reach their audiences in new and innovative ways.

Assets / Competitive Advantages

There is no doubt that we have a lot of work to do to better meet the full spectrum of both our listeners' and advertisers' needs. But there is *also* no doubt that we have a great set of assets, which form a solid foundation on which to build.

To start, Pandora has **unparalleled scale**. We are the largest streaming audio service in the United States -- both for listeners and for advertisers. From a listener perspective, with 73.7 million active users, we touch more Americans than any other streaming music service. And from an advertiser perspective, we represent roughly two-thirds of all digital audio inventory making us the *largest* publisher of digital audio advertising in the US.

Pandora also enjoys **massive distribution** across a host of smart devices - in cars, connected speakers, and of course, mobile devices. In fact, Pandora is available today on over 2,000 unique devices, and growing; giving our listeners flexibility in how and where they listen, and advertisers the ability to reach their audience in myriad ways.

Another key advantage I've been impressed with is our **wealth of data and our advanced data science capabilities.** Pandora has more than 85 billion elements of feedback from our listeners and their musical tastes generated over 17 years. Data is at the core of our proprietary Music Genome Project - it's what fuels our ability to choose exactly the right next song for a listener. And increasingly, we see opportunity to use that data and our data science capabilities - along with new ad technology - to deliver the right ad to our listeners at just the right moment.

A final asset I'll touch on is Pandora's unique, **three-tiered service model.** With the launch earlier this year of Pandora Premium, our on-demand service, and the refresh of Pandora Plus, we're now beginning to address all forms of listening on our platform -- whether people are looking for a free ad-supported account, a flexible, ad-free subscription, or a full on-demand product. There is no longer a reason to leave Pandora for a different listening experience.

Meanwhile, it's our ability to effectively monetize our ad-supported audience - a challenge that only we in the industry have managed to solve - that allows us to sustain our other offerings. This gives us a leg up in a business that's otherwise challenged by high content costs and tight margins.

After taking a deeper look under the hood, the unique interplay of Pandora's advantages - our scale, our massive and expanding distribution, our wealth of data, and our three-tiered model - has left me even more excited about the possibilities for our business.

Near-term Challenges

Now, this isn't to say there aren't some real issues that we need to address, and we need to address them quickly. Pandora is very much a business in transition, and there are tangible challenges.

In particular:

- our user base has declined in recent quarters;
- our ad revenue has not grown as much as we would have liked; and, as a result,
- our shareholders returns have been poor.

These are the challenges I'm focused on addressing so we can achieve long-term success. How will we do it? Simply stated, I want us to execute simultaneously against two macro goals: *First*, it is essential that we stabilize and then grow our base of listeners. *Secondly*, we need to hold onto and build on our status as a best-in-class publisher of targeted digital advertising, which means a significant upgrade to our advertising technology and the capabilities we can offer advertisers.

Areas of Focus

Let me first expand on the listener point. We have more than 93 million users who come to Pandora on a quarterly basis, but only 73.7 million MAUs. So how do we get folks to engage more frequently and more extensively? I see at least four opportunities that, over time, can materially bend the curve on active users.

1. **The first is by tapping into new forms of content.** To-date, Pandora has primarily been a music-focused service. During 2018, we will expand on the initial success we saw with *Serial* and *This American Life*. New forms of content - like podcasts, spoken word, and traditional radio -- will expand engagement with our existing audience and attract new and lapsed listeners. Now, by no means will non-music content become the majority of our listening, but we do expect, over time, that it will be material both in terms of driving usage and in normalizing and potentially lowering our overall effective content costs. Tapping into a rapidly growing market, we will harness our scale, distribution, data and discovery capabilities -- all of the advantages I just spoke about -- to deliver non-music content in a very unique way. In turn, I believe these new forms of content will help draw a broader audience into Pandora and to the core music service we offer.

2. Now, I also see opportunity with **new methods of distribution**. There's a very significant shift happening in how people access audio content. Digital audio, which used to be limited to mobile devices and the web, is now exploding into new forms of listening, integrated into new smart devices, connected homes and auto …all of which is beneficial for Pandora.

   Take the area of the connected home, for example. It's no secret that voice-activated devices are exploding as a category. Pandora listening on voice-activated devices is up 300% year-over-year. These devices are a perfect match for Pandora, since they highlight the value of both interactive and lean-back listening experiences. They also expand the potential for future innovation with voice-activated advertising.

We'll be expanding our partnerships with new and existing device partners to make sure all three tiers of Pandora's service show up on all the devices we're on, taking full advantage of the scale and audience our partners offer…and making sure the overall experience is intuitive and seamless.

For example, being Comcast's preferred music partner has helped introduce Pandora into millions of living rooms. Right now we are working with them on a deeper integration that will bring Pandora even more to the forefront of the X1 experience, right next to other best-in-class entertainment providers like Netflix, YouTube and HBO. The compelling aspect of these partnerships is the ability to drive direct billed subscribers which can lead to better economics in the business. Expect to see more details about our deeper integration with Comcast soon and more partnerships like this with other Tier 1 partners.

3. **Third, I see a big opportunity to attract and retain listeners by bringing more competitive features to our ad-supported tier.** The industry has seen a big shift in listening toward ad-supported, or "free", on-demand, as exhibited by the emergence and growth of YouTube, Vevo and others. When you look at the top reasons why listeners leave the Pandora experience, it's because they cannot hear the song they want on-demand. This is particularly important to younger listeners.

We've taken some steps to find new, creative ways to unlock interactive features in our ad-supported tier with innovative products like Sponsored Listening - an ad product that rewards listeners with more skips and replays when they complete an ad view. And we're committed to finding more ways to add competitive features to our ad-supported tier, so we can participate in this market opportunity; and do so in a way that delights listeners and benefits artists and other rightsholders.

We know there is power in marrying rewards-based advertising to the features our listeners are seeking. And I believe there is space for us to do more in this area -- so we can draw in and engage listeners, while at the same time delivering high-value attention opportunities to our advertisers.

4. **Finally, I believe we'll see significant return by optimizing our marketing execution.** So as new forms of content, new partnerships and new innovative features start coming online, we'll be making sure we're telling people about them in the most effective, efficient way possible. This starts with an acute focus on performance marketing. We will make sure we're allocating our marketing dollars in a disciplined way that's based on an assessment of the full lifetime value of the audience we're gaining.

   I also believe we can leverage our partners and partner marketing more aggressively and in ways we haven't in the past to drive joint results. A great building block is our recent T-mobile Tuesdays promotion -- a showing of two strong brands coming together to benefit both companies and our customers.

   Both of these areas - performance and partner marketing -- are ones I have significant experience with from my time at Sling. While it may take some near-term investment in our marketing technology tools to automate this as much as possible, based on my experience it will be well-worth it. We're fortunate at Pandora that we have a wealth of data and data science capabilities to pull from that will allow us to personalize our marketing in an intelligent and targeted way. Combined with a performance and partner led approach, I expect we'll see much greater return from the marketing dollars we spend in terms of attracting and scaling our audience across all our tiers.

Now let me switch over to discussing the other big issue that I'm focused on addressing, our **ad tech gaps**. One consistent theme I've heard from advertisers is that we don't have all the features they need to easily transact with us and drive their campaigns. And this *is* starting to have a material impact on our revenue.

We know that we need to invest in our ad tech to make Pandora a more efficient advertising partner and to become more competitive with our digital peers. And we are continuing to bring more engineering resources to focus on improvements in this area.

This includes expanding access to our data and engagement metrics, so advertisers can monitor and adjust their campaigns more quickly and increase their ROI. And, increasing the number of ways partners can transact with us, through both programmatic capabilities -- which we recently made available in beta on video, coming soon on audio -- and, eventually, with self-service tools.

Investing to shore up our ad tech gaps will take some time to develop and implement, but will provide returns in several ways:

1. We expect to see a direct impact to our top line revenue by recapturing lost dollars;
2. The improvements will also help our bottom line by removing inefficiencies in the very manual way the team currently needs to work to fulfill orders and requests; and
3. They will help unlock new revenue opportunities in markets we currently don’t serve -- making sure we’re able to capture all parts of the demand curve.

As I said, we know this work will take time. And because of the urgency, we're going to look carefully at both build versus buy options.

If we’re successful with these investments, and combine new technology with the existing data science capabilities I described, I believe we can intelligently raise ad load, increase sell-through, command premium pricing, and ultimately drive faster revenue growth . . . all while protecting the listener experience.

Improving ad tech is just one example of how we can operate in smarter ways across our business to drive results and improve operating leverage over time. I see opportunities for automation, operational efficiencies and investment focus in many areas -- from how we transact, to how we bill, measure, and market.

Given the nature of these opportunities, there's no silver bullet that will immediately address all the challenges I laid out. We need to focus on reviving user growth at the same time we improve our ad tech, while also ensuring we are making decisions that set us up for long-term profitability.

If we're able to do these things in tandem, I believe we will see shareholder value start to build throughout 2018 and beyond.

Conclusion

To me, achieving all this together for our listeners, advertisers, shareholders, employees and partners is an exciting challenge that is within our reach, and the exact reason I joined Pandora. I very much look forward to working with our newly constituted board of directors and our new investor, Sirius XM, to drive our business forward.

Now I'll turn the call over to Naveen to review our third quarter results. Naveen?

Naveen Chopra

Brief Overview of Q3 Financials

Thanks Roger. And welcome to your first Pandora earnings call.

The third quarter included some important changes for Pandora, most notably Roger coming on board, the completion of the second tranche of the Sirius investment, and closing of the Ticketfly sale. Financially, Q3 was a solid quarter with revenue of $378.6 million, slightly above the midpoint of our guidance. Revenue grew 10% year-over-year after adjusting for the divestiture of Ticketfly and the exit of our Australia / New Zealand business. Adjusted EBITDA in Q3 was a loss of $5.3 million, which is very close to the top end of our guidance. I'll share more detail on revenue and adjusted EBITDA drivers in a moment, but first I'll walk through some important listener engagement metrics.

Active Users, Hours, and Engagement

For the quarter, active users were 73.7 million. It's important to remember that this active user number excludes approximately 1.1 million active users from Australia/New Zealand, where we ceased operations during the quarter. Adjusting for ANZ, actives were down 4% year-over-year, a part of which we attribute to the natural disasters that occurred in Texas and Florida. Those regions typically generate heavy Pandora listening by virtue of their large populations. Total hours, again adjusted for ANZ, declined by approximately 4% year-over-year, which was an improvement over the 7.9% year-over-year decline we experienced in Q2. This quarter, total hours were primarily impacted by the decrease in active users and to a lesser extent, hours controls and playlist enhancements. These dynamics also caused a year-over-year decline in ad hours. Additionally, ad hours were impacted by the movement of ad-supported listeners to our subscription tiers and participation in subscription trials. Listener engagement continues to be strong. Monthly hours per active listener were the second highest ever at 23 hours per listener.

As Roger noted, stabilizing and ultimately growing our audience is a major priority, and we have a number of initiatives underway that are designed to reengage lapsed listeners, starting with the roughly 20 million gap between our monthly and quarterly active users. We have several powerful levers to apply in this area, including new forms of content like podcasts and traditional radio content, compelling new features in our ad-supported product, deeper integration with connected devices, and a focus on marketing optimization. We are bullish about the potential of these initiatives but also conscious of the fact that it may take a few quarters to stabilize and ultimately return to listener growth.

Q3 Advertising Revenue

Q3 advertising revenue was $275.7 million, up approximately 1% year-over-year when adjusting for the shut-down of ANZ. Ad RPM grew 21% year-over-year to $70.27, setting an all-time high. The increase in ad RPM versus the year ago period was driven by higher ad-loads, an increase in blended effective CPMs, and to a lesser extent, improvements in sell through.

As expected, we continue to see strong improvements in audio CPMs, which increased 16% sequentially and 47% from Q1 to Q3 of 2017. We expected this improvement starting because we have consciously moved away from performance-based audio advertising and pushed more inventory through premium channels.

We believe Q3 advertising revenue would have been higher were it not for four identifiable headwinds that materialized toward the end of the quarter. These included:

- Weak macroeconomic conditions for our retail, automotive and CPG categories
- Listener hour declines which I referenced earlier
- Ad sales slowdown in hurricane affected areas
- and ad-tech limitations in several key areas.

Now obviously, some of these headwinds are beyond our control, but the ones that are controllable, define our near-term investment priorities. Namely, the audience growth initiatives I described, and the critical need to enhance our ad-tech position. As I have previously shared, we have opportunities to capture significantly more ad revenue growth through the development of innovative ad formats, improved measurement and ROI capabilities, and new transaction options including both programmatic and self-serve. Additionally, we believe operating leverage in the advertising business can be improved with investments in technology that reduce the amount of manual work in several parts of our advertising operation. I think it is fair to say that Roger and I both see our ad-tech gaps and audience growth initiatives as equally important priorities in driving future growth for Pandora.

Subscription Revenue

Subscription and other revenue was $84.4 million, an increase of 50.5% over the same period in 2016. We added 320,000 net new subscribers in Q3, bringing our cumulative subscriber base to 5.19 million. I also note that, as of today, we have obtained well over 1 million Premium subscriptions, and we continue to develop new go-to-market partnerships, family and student plans, and bring Premium to desktop, tablet, CE, and auto platforms. These results demonstrate the important strategic role that subscriptions play in our business. There are clearly a meaningful number of listeners seeking interactive features, and we now have compelling subscription services to keep those users in our ecosystem and generate incremental contribution margin. But at the same time, it is clear that there are many users who prefer to remain in an ad-supported tier or a lower priced subscription. These users are also highly valuable to us, so we expect to continue our portfolio approach by enhancing features across all service tiers and by targeting our marketing to ensure we steer listeners to the stickiest tier in light of their personal usage habits.

Content Costs

While total content costs as a percentage of total revenue increased from 50% to 54% year-over-year, ad-related content costs as a percentage of advertising revenue decreased approximately 2% from the year ago quarter, reflecting increases in ad RPM and illustrating the opportunity to expand contribution margins pandora®

in our ad-tier through topline growth. Q3 ad LPM was $37.01. Relative to the year-ago period the increase in ad LPM reflects the impact of direct deals and minimum guarantees. The sequential increase in ad LPM is caused by accruals for certain tier-specific minimum guarantees. Additionally, Q2 and Q3 LPMs reflect the fact that we are not yet eligible for volume discounts tied to certain subscriber thresholds. We expect ad LPMs to continue to fluctuate as subscriber trajectories evolve due to the nature of accounting for minimum guarantees (MGs). In fact, we expect ad LPMs to decline materially in Q4 as the impact of MGs will be less significant and because we have negotiated modifications with some of our content partners.

On the subscriber side, Q3 licensing cost per subscriber (or LPU), was $3.87, up from $2.14 last year, and from $3.11 in the prior quarter. These increases are largely driven by the mix shift from Pandora Plus to Premium.

Gross Margin

Non-GAAP gross margin was 37%, compared to 40% in the year-ago quarter. The decline in margin year-over-year was driven by higher content costs under direct deals versus statutory rates. Sequentially, Non-GAAP gross margin increased from 36% in Q2 to 37% in Q3, driven by higher RPMs during the quarter. We continue to expect gross margins to improve over time with improvements in ad monetization, and as we achieve scale benefits in the subscription side of the business.

Q3 Operating Expenses

Turning to operating expenses, for the third quarter of 2017 non-GAAP sales and marketing expense was $92.9 million, compared to $97.8 million a year-ago. The reduction reflects different timing of external marketing spend relative to 2016 and also incorporates the sale of Ticketfly. We continue to expect full-year sales and marketing expense for 2017 to be comparable to 2016. Sequentially, Non-GAAP sales and marketing expense was down $33.7 million, due to the marketing campaign we ran in Q2 to support the launch of Premium.

Non-GAAP product development expense was $30.9 million for the third quarter, an increase of 27% compared to the third quarter of 2016. This increase reflects an increase in engineering headcount and a reduction in capitalized development. Product development expenses declined sequentially due to the sale of Ticketfly.

Non-GAAP G&A expense was $31.6 million, a decline of 3.7% compared to the year ago period. G&A was also down as a percent of revenue, from 9.3% in the year-ago quarter to 8.3% in Q3 as a result of the workforce reduction earlier in the year and the sale of Ticketfly. We expect G&A as a percentage of revenue, as well as absolute dollars, to decline for the remainder of the year due to the sale of Ticketfly.

Adjusted EBITDA

As noted earlier, adjusted EBITDA for the third quarter was a loss of $5.3 million, near the top end of our guidance range. Notably, non -GAAP Sales and Marketing expense, G&A expense, and total operating expense represented a lower percentage of revenue compared to the year-ago quarter. We continue to look for opportunities to achieve operating leverage, while focusing investment in high-priority areas.

EPS

Third quarter 2017 GAAP basic and diluted net loss per share was $0.34. Non-GAAP basic and diluted net loss per share was $0.06. GAAP and non-GAAP basic and diluted EPS were based on 246 million weighted average common shares outstanding.

Balance Sheet and Cash Flow

We ended the third quarter with $499.4 million in cash and investments compared to $227.6 million at the end of the prior quarter. Our ending cash balance incorporates $307.5 million of gross cash proceeds from the close of the second tranche of the Sirius investment and $150 million of gross cash proceeds from the sale of Ticketfly. During the quarter we used $79.2 million of cash in operating activities. As a reminder Q3 tends to be a period of heavy cash usage due to the timing of prepayments around the anniversary of our label deals. Additionally, during Q3 we repaid the $90 million balance on our revolver.

Guidance

I'd now like to address Q4 guidance. From a qualitative perspective, we expect many of the headwinds that constrained ad revenue in Q3 to sustain through Q4. We expect market conditions in retail, CPG, and auto accounts to remain challenging, resulting in continued pressure on our advertising revenues. Additionally, the MAU trends and ad-tech challenges we face will take some time to address, and will therefore, also impact advertising revenue in Q4. Quantitatively, we expect Q4 total revenue in the range of $365 to $380 million, the midpoint of which reflects 3.3% growth versus the year ago period when adjusting for Ticketfly, ANZ, and roughly $10 million of political advertising revenue we recognized last Q4. Our Q4 revenue guidance incorporates continued subscription growth offset by a year-over-year reduction in advertising revenue. With respect to the year-over-year ad revenue trend in Q4, it is important to note that 2016 included significantly better than expected overall ad results and a heavy political year. Q4 adjusted EBITDA is expected in the range of a $15 million loss to a $5 million loss. Adjusted EBITDA differs from GAAP net loss in that it excludes forecasted stock based compensation expense of approximately $34 million, depreciation and amortization expense of approximately $14 million, other expense of approximately $6 million and provision for income taxes of approximately $0.4 million and assumes minimal cash taxes given our net loss position. The company is currently forecasting a non-GAAP effective tax rate of approximately 32% to 37% for the full year 2017. However, the company is not expected to incur any material cash taxes due to its net operating loss position. Basic shares outstanding for the calendar year 2017 are expected to be approximately 244 million. Basic shares outstanding for the fourth quarter of 2017 are expected to be approximately 249 million.

Summary

I'd like to close by saying that I look forward to working closely with Roger and the rest of the Pandora team as we pursue several key initiatives to expand our audience and enhance monetization. We have great assets from which to build and a strong balance sheet to support growth. Though it's not an overnight process, I believe Pandora is now focused on realistic execution toward a plan that leverages our strengths to achieve sustained profitability and corresponding returns for our shareholders.

With that, I'll turn the call to the operator, who will open the line for your questions. Operator?