

PANDORA MEDIA INC. (P, FAIR VALUE, PT: \$16.00, CLOSE: \$15.41)

P: Key Takeaways From Pandora Analyst Day

March 6, 2015

We attended Pandora's analyst day yesterday in San Francisco and came away with added comfort around P's continued local salesforce build-out, given new disclosure of salesforce productivity metrics which indicate strong productivity growth over time across both large and smaller media markets. However, we were somewhat disappointed by a lack of detail on P's mobile programmatic ad products and strategy, as well as newly disclosed RPM metrics which appear to indicate that PC-based display ad revenue (admittedly, now less than 10% of total ad revenue) declined 12% YoY in 2014. In our view, Pandora still remains in the early stages of penetrating its core audio advertising opportunity and we believe that management's mid-term goals of 100M + monthly active users and 3B+ monthly hours of usage are realistically achievable over a 3-4 year timeframe (if not sooner). However, while we remain bullish on Pandora's opportunity, we believe the case for longer-term optimism laid out by management remains balanced by near-term concerns, most notably the CRB rate court overhang. We maintain our Fair Value rating and \$16 price target on P shares.

Local Salesforce Productivity Trend Should Increase Confidence in Continued Investment. Pandora management highlighted strong local salesforce productivity growth over time, across both large and smaller media markets. We believe these new data points should provide investors with additional comfort as Pandora continues to scale the local salesforce in 1H15. Management also noted the continued time spent vs. local monetization gap. Given the \$15B local radio advertising opportunity, Pandora estimates its "fair share" of the market at \$1.5B based on its 10% share of radio listening, versus P's actual \$200M in local ad sales in 2014.

Programmatic Push Promising, But Key Questions Still Unanswered. As on the Company's 4Q earnings call, Pandora signaled its ambitions in mobile programmatic advertising. We are constructive on Pandora's potential here, given its large, logged-in and highly engaged mobile user base and strong data assets, but we were somewhat disappointed not to see additional, concrete details on the Company's programmatic product and strategy roadmap. We also note that we believe the Company's push into mobile programmatic advertising could be partly in response to headwinds in traditional (i.e., PC-based) display: new RPM metrics issued by the Company yesterday appear to indicate that Traditional Display ad revenue (admittedly, now less than 10% of P's total ad revenue) declined 12% YoY in 2014.

Marketing and Product Innovations Fuel Push to 100M Users and 3B+ Monthly Listener Hours. Pandora aims to achieve 100M active listeners and 3B+ monthly ad hours over the medium term, goals which we believe are realistically achievable given P's nascent user marketing and product enhancement initiatives—even assuming no acceleration from the growth rates exhibited in 4Q, it should take Pandora just over three years to achieve 100M active listeners (P attracted *more than* 100M unique active listeners over the past three months) and about four years to reach 3B monthly listener hours. We continue to view in-car listening as P's biggest potential source of incremental listener hours (outside of further international expansion)—Pandora significantly under-indexes on in-car listening, with just 2% share of U.S. in-car radio listening vs. 13% share at home, 17% at work, 23% "on-the-go" and 9.7% share overall; and, we note that P's connected-car metrics appear promising—connected-car user activations and listening grew 100% YoY in 2014 and connected-car activations drive ~40% increase in daily frequency.

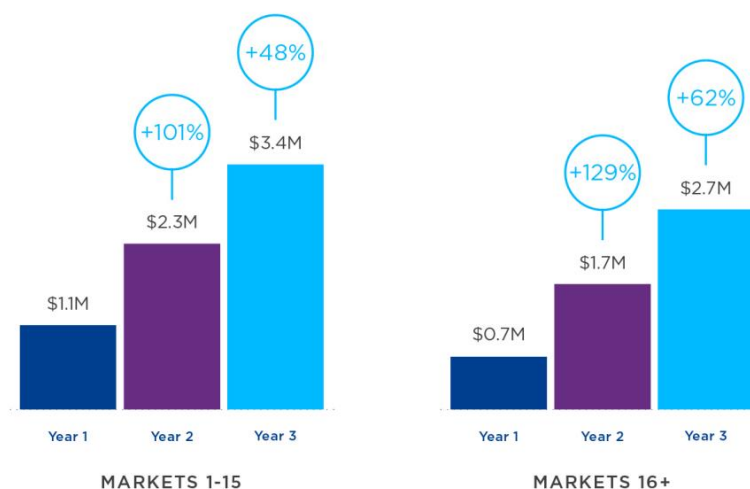
Maintain Fair Value Rating and \$16 Price Target. Our \$16 price target is based on 2.5x our 2016E sales forecast of \$1.45B and 20x our 2016E EBITDA forecast of \$144M. Risks to our price target include decelerating user and usage growth, increasing operating expenses, risks related to content costs and the CRB rate court process, and competition.

Company Note Fair Value - PT: \$16.00

Key Takeaways from Pandora Analyst Day

Local Salesforce Productivity Trend Should Increase Confidence in Continued Salesforce Investments. Pandora management highlighted strong local salesforce productivity growth over time, across both large and smaller media markets, as illustrated in the exhibit below.

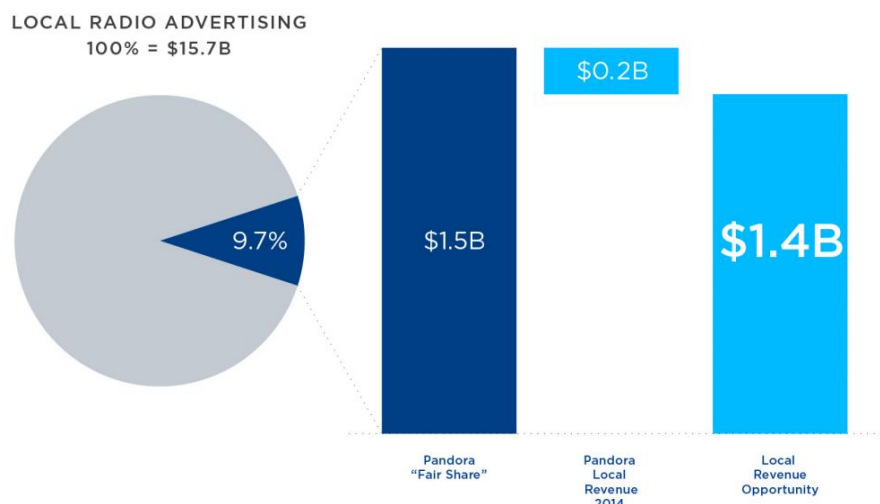
Exhibit 1. Pandora Local Sales Productivity Growth Trends



Source: Company reports

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Exhibit 2. Pandora "Share of Ear" vs. Share of Local Radio Budgets



Source: Company reports, eMarketer, Edison Research

Programmatic Push Appears Promising, But Key Questions Still Unanswered. As on the Company's 4Q earnings call, Pandora signaled its ambitions in mobile programmatic advertising. We are constructive on Pandora's potential here, given its large, logged-in and highly engaged mobile user base and strong data assets, but we were somewhat disappointed not to see additional, concrete details on the Company's programmatic product and strategy roadmap. We also note that we believe the Company's push into mobile programmatic advertising could be partly in response to headwinds in traditional (i.e., PC-based) display: new RPM metrics issued by the Company yesterday appear to indicate that Traditional Display ad revenue (admittedly, now less than 10% of P's total ad revenue) declined 12% YoY in 2014. Our analysis is illustrated in the exhibit below.

Exhibit 3. Pandora Audio vs. Display Revenue Analysis

	2012	2013	2014
Total Display Ad RPM	\$14.02	\$14.61	\$14.41
<i>YoY Growth</i>		4%	-1%
Total Audio Ad RPM	\$14.90	\$21.05	\$27.25
<i>YoY Growth</i>		41%	29%
Traditional Display Ad RPM (Implied)	\$28.91	\$27.67	\$24.33
<i>YoY Growth</i>		-4%	-12%
Traditional Audio Ad RPM (Implied)	\$24.54	\$28.18	\$37.70
<i>YoY Growth</i>		15%	34%
Mobile Display Ad RPM	\$9.91	\$11.55	\$12.55
<i>YoY Growth</i>		17%	9%
Mobile Audio Ad RPM	\$12.24	\$19.38	\$25.29
<i>YoY Growth</i>		58%	30%
(\$M)	2012	2013	2014
Total Display Ad Revenue	174.8	213.5	253.3
<i>YoY Growth</i>		22%	19%
Total Audio Ad Revenue	185.8	307.7	479.0
<i>YoY Growth</i>		66%	56%
Total Ad Revenue	360.7	521.2	732.4
<i>YoY Growth</i>		45%	41%
Traditional Display Ad Revenue	78.0	76.8	67.5
<i>YoY Growth</i>		-2%	-12%
Traditional Audio Ad Revenue	66.2	78.2	104.7
<i>YoY Growth</i>		18%	34%
Total Traditional Ad Revenue	144.2	155.0	172.2
<i>YoY Growth</i>		7%	11%
Mobile Display Ad Revenue	96.9	136.8	185.8
<i>YoY Growth</i>		41%	36%
Mobile Audio Ad Revenue	119.6	229.5	374.4
<i>YoY Growth</i>		92%	63%
Total Mobile Ad Revenue	216.5	366.2	560.1
<i>YoY Growth</i>		69%	53%

Source: Company reports and CRT Capital Group LLC estimates

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We are also constructive on Pandora's efforts to drive audience growth and listener hours via branded and targeted marketing programs. Management noted that the Company's marketing via “owned media,” and specifically mobile push notifications (where Pandora has an impressive 90M+ users who have opted in to receive push notifications), helped drive 19% YoY growth in hours on Christmas Eve 2014 (in the context of 15% YoY hours growth in 4Q14), resulting in Pandora's first-ever day with more than 30 million active listeners. Beyond owned media, we believe that Pandora is making good use of earned media (both PR and earned social media impressions) and impressive use of paid marketing. The Company highlighted its use of FB's Custom Audiences and lookalike targeting ad products to activate/reactivate new/idle users, with strong ROI (payback period averaging three months).

“Global Music Marketplace” Vision Suggests New Revenue Models Longer-Term. While music industry relations remain challenged given the current CRB rate court process, P outlined its value proposition to artists and its ambitions to create a “global music marketplace” over the longer term. Pandora's case studies outlined the Company's ability to leverage its deep data assets to create unique, experiential marketing opportunities and to drive significant engagement and sales lift for artists. While we don't see significant near-term revenue opportunity from P's efforts in this vein, we wouldn't rule out new revenue models longer-term, including, perhaps, a paid, on-demand streaming offering, single-copy music download sales, or concert ticket and merchandise sales.

Cautiously Optimistic on Pandora's International Ambitions. Management made the case for a global Pandora, articulating the Company's ambition to serve hundreds of millions of active listeners worldwide over the 2020+ timeframe. We remain cautiously optimistic on Pandora's longer-term international opportunity, and believe that the Company's increasingly conciliatory tone toward the music industry (outside, of course, of the CRB proceedings) could facilitate Pandora's eventual expansion into regions without compulsory licensing frameworks.

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Buy	Expected rate of return on investment at current prices levels is above that rate required, in CRT's view, to undertake the attendant risks perceived- positive risk/reward investment balance.
Fair Value	Expected rate of return on investment at current prices levels is in line with that rate required, in CRT's view, to undertake the attendant risks perceived- equitable/reward investment balance.
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Fair Value 29.84%	0.00%
Sell 0.00%	NaN%

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