

# ACCOUNTING

## in the headlines

### How can a common-size income statement help analysis of Pandora's results of operations in 2015 compared to 2014?

Pandora Internet Radio by Pandora Media ([P](#)) is a streaming music service. Its free advertising-supported radio service was first launched in 2005. Pandora users streamed 20.03 billion hours of internet radio during 2014. In December 2014, there were 81.5 million active users of Pandora, making it the largest streaming music service currently. Pandora has a database of over 1,000,000 songs from over 125,000 artists.

Pandora offers its streaming music through two services:

1. Free Service: This option allows the listener access to the music by including advertisements.
2. Pandora One: This option is a paid subscription model without any advertisements; it also allows users to have more daily skips and longer listening times.

While Pandora currently has plenty of cash from its investors, it has yet to generate a profit since its inception. Pandora is facing increasing competition from sources such as Apple Music (approximately 6.5 million subscribers in 2015), Spotify (approximately 20 million paid subscribers in 2015), and other streaming services. In addition, Pandora's costs in some areas are increasing.

Pandora recently released its earnings for the third quarter of 2015. Earnings were less than expected by investors and Pandora's stock price fell sharply. At the end of this posting, excerpts from Pandora's statement of operations is provided, both in dollars and in common-size formats. Use those excerpts to answer the questions.

#### Questions

1. Using the statement of operations excerpt *in dollars*, what can you say about how Pandora is doing in the third quarter of 2015 compared to the third quarter of 2014? What can you say about how Pandora is doing for the nine months ended September 2015 compared to September 2014? Can you tell if the rate of increase is greater for revenues or expenses from 2014 to 2015? Why or why not?
2. Using the statement of operations excerpt *in dollars* again, why is the loss from operations larger in 2015 than in 2014?
3. Using the *common-size* statement of operations excerpt, what can you say about how Pandora is doing in the third quarter of 2015 compared to the third quarter of 2014? What can you say about how Pandora is doing for the nine months ended September 2015 compared to September 2014? Is the rate of increase is greater for revenues or expenses from 2014 to 2015?
4. Using the *common-size* statement of operations excerpt again, why is the loss from operations larger in 2015 than in 2014? Also, what can you say about the mix of advertising revenue versus subscription revenue?
5. Which statement (dollars versus common-size) is more useful for analyzing the financial performance of Pandora in this case? Explain.

Copyright © 2015 by Dr. Wendy Tietz, <http://accountingintheheadlines.com/>

This work is licensed under a [Creative Commons Attribution-NonCommercial 3.0 Unported License](https://creativecommons.org/licenses/by-nc/3.0/).

Pandora Media, Inc.					
Excerpt from Condensed Consolidated Statements of Operations - in DOLLARS					
(in thousands, except per share amounts) - UNAUDITED					
		Three months ended		Nine months ended	
		September 30,		September 30,	
		2014	2015	2014	2015
Revenue					
	Advertising	\$ 194,293	\$ 254,656	\$ 512,251	\$ 664,316
	Subscription and other	45,300	56,906	140,551	163,570
Total revenue		239,593	311,562	652,802	827,886
Cost of revenue					
	Cost of revenue - Content acquisition costs	111,315	211,272	331,051	467,429
	Cost of revenue - Other	15,453	21,414	44,421	57,690
Total cost of revenue		126,768	232,686	375,472	525,119
Gross profit		112,825	78,876	277,330	302,767
Operating expenses					
	Product development	13,381	21,849	38,288	56,466
	Sales and marketing	72,320	107,286	200,416	285,595
	General and administrative	29,143	35,603	81,369	111,169
Total operating expenses		114,844	164,738	320,073	453,230
Loss from operations		\$ (2,019)	\$ (85,862)	\$ (42,743)	\$ (150,463)
Source: Pandora Media, Inc., 3rd Quarter 2015, Financial Results					

Pandora Media, Inc.					
Excerpt from Condensed Consolidated Statements of Operations - COMMON-SIZE					
(in thousands, except per share amounts) - UNAUDITED					
		Three months ended		Nine months ended	
		September 30,		September 30,	
		2014	2015	2014	2015
Revenue					
	Advertising	81%	82%	78%	80%
	Subscription and other	19%	18%	22%	20%
Total revenue		100%	100%	100%	100%
Cost of revenue					
	Cost of revenue - Content acquisition costs	46%	68%	51%	56%
	Cost of revenue - Other	6%	7%	7%	7%
Total cost of revenue		53%	75%	58%	63%
Gross profit		47%	25%	42%	37%
Operating expenses					
	Product development	6%	7%	6%	7%
	Sales and marketing	30%	34%	31%	34%
	General and administrative	12%	11%	12%	13%
Total operating expenses		48%	53%	49%	55%
Loss from operations		-1%	-28%	-7%	-18%
Source: Pandora Media, Inc., 3rd Quarter 2015, Financial Results					