Name:____

Problem 1. Business Strategy Analysis

(i) Pandora competes with broadcast radio providers, including terrestrial and satellite radio providers. List one key success factor and key risk of Pandora's business model relative to the business models of broadcast radio providers. **[4 points]**

1. Key success factor

2. Significant risk

(ii) Summarize the key financial challenge(s) faced by Pandora in offering its service through mobile devices. **[3 points]**

Problem 2. Accounting Analysis

(i) Summarize the accounting policies used by Pandora in the most recent fiscal year for the recognition of revenue associated with the sale of advertising. **[3 points]**

(ii) Assume that instead of using its current accounting policies for the recognition of revenue, Pandora instead recognized revenue when it received the associated cash from customers. Estimate the Loss (income) from operations that Pandora would have reported for the most recent fiscal year. **[6 points]**

(iii) Summarize the accounting policies that Pandora uses for marketing and sales expenses. **[2 points]**

(iv) Assume that instead of using its current accounting policy for marketing and sales expenditures, Pandora instead capitalized marketing and sales expenditures in the fiscal year in which they were incurred and then amortized them on a straight-line basis over the subsequent two fiscal years. Estimate the Loss (income) from operations that Pandora would have reported for the most recent fiscal year. **[6 points]**

(v) Which of the above two accounting policies for marketing and sales expenditures do you think better reflects the underlying economics of these expenditures at Pandora? Briefly justify your answer. **[3 points]**

Problem 3. Financial Analysis

(i) Compute the Gross Margin ratio for Pandora and Sirius for the most recent fiscal year. **[4 points]**

Gross Margin for Pandora =

Gross Margin for Sirius =

(ii) Briefly identify the primary reason(s) for the difference between the gross margins that you computed above? **[4 points]**

(iii) Estimate the average number of days that elapsed between the recognition of content acquisition costs and their subsequent payment for Pandora during the most recent fiscal year (note that you are only asked to do this computation for Pandora and not Sirius). **[4 points]**

Average number of days for Pandora =

(iv) In the fiscal year ended January 31 2012, Pandora raised $90.632M in its initial public offering. Identify the main uses of the proceeds of the offering during that fiscal year. **[6 points]**

Problem 4. Forecasting

(i) The Cowen and Company research report provided in the financial statement booklet forecasts that Pandora's revenue will grow from $427.1M in the most recent fiscal year to $2,824.2M in 2019 (see Exhibit 5 of the report). Evaluate the plausibility of this forecasting assumption. **[4 points]**

(ii) The Cowen and Company research report provided in the financial statement booklet forecasts that Pandora's operating margin will grow from (8.8)% in the most recent fiscal year to 32.1% in 2019 (see Exhibit 5 of the report). Identify the key drivers of the improved margin. **[6 points]**

(iii) The income statement model in Exhibit 5 of the Cowen and Company research report forecasts that the line item 'Wtd. Avg. Shares Outstanding' for 'Diluted EPS-GAAP' will increase from 168.3 in the most recent fiscal year to 180.3 in 2019. Briefly evaluate the plausibility of this forecast. **[4 points]**

(iv) The balance sheet model in Exhibit 8 of the Cowen and Company research report forecasts that the line item 'Accounts Receivable' will grow from 103.4 in the most recent fiscal year to 429.6 in 2019. Briefly evaluate the plausibility of this forecast. **[5 points]**

Problem 5. Valuation Analysis

(i) The Cowen and Company research report uses a terminal year of 2019 for its DCF valuation analysis (see Exhibit 4). Compute the terminal year 'return on equity' implied by the forecast financial statements in the Cowen and Company Report. **[4 points]**

(ii) Briefly explain whether the terminal year return on equity is plausible. **[2 points]**

(iii) The Cowen and Company research report forecasts significant stock-based compensation expense through the 2019 terminal year. Does the DCF analysis in Exhibit 4 incorporate the economic cost of stock-based compensation? If not, provide a brief qualitative explanation of how you would incorporate this economic cost. **[5 points]**

This is the end of the exam.