



P: WEBCASTER IV = POWDER KEG

WEB IV ANALYSIS AND IMPLICATIONS

September 24, 2015

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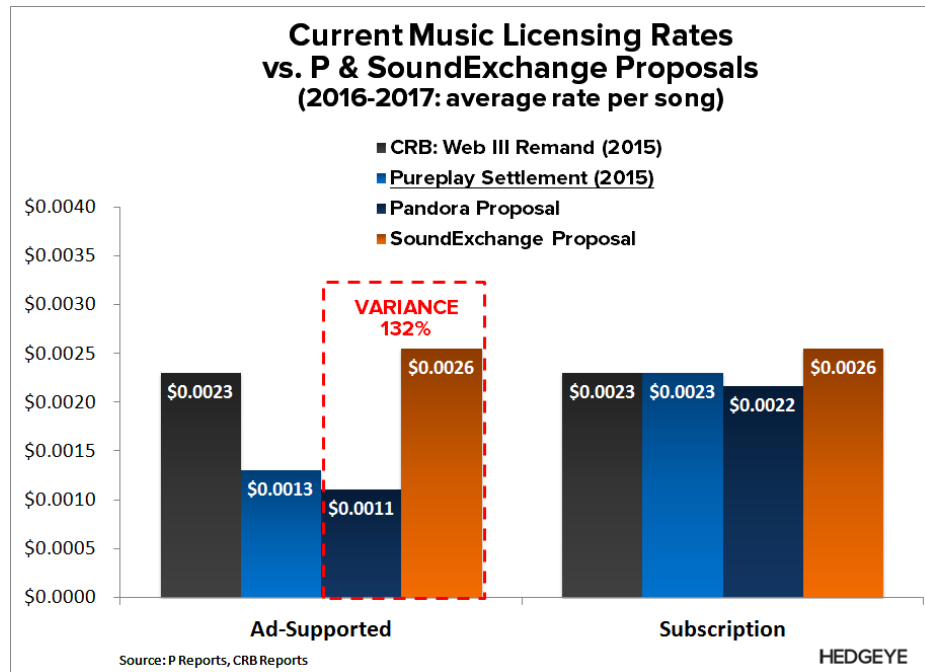
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QA@HEDGEYE.COM

**ANSWERED AT THE END OF THE CALL*

P: WEBCASTER IV = POWDER KEG

1. **Business Model:** Advertising-focused model. P must pay for every song it streams, regardless of whether it is serving ads on those listener hours.
2. **Analysis:** P hasn't achieved any material operating leverage to date. P's efforts to increase monetization have led to rampant user attrition.
3. **Outlook:** We expect P to lose the one Web IV debate that it can't (bifurcated royalty rates). P's model can't handle much more than a best case scenario.
4. **Setup:** Web IV will be decided sometime in December, but the Street believes P received a preliminary victory already (it didn't)
5. **Short Duration:** Exit between 4Q15 and 1H16



CHALLENGING BUSINESS MODEL, WHICH MAY NOT SURVIVE WEB IV

P is running an ad-focused business model, which has yet to produce any meaningful profitability despite discounted Pureplay rates. P's model is only sustainable if it gets its way on Web IV; that doesn't appear likely

P: WEB IV PRESENTATION OUTLINE

1

A CHALLENGING BUSINESS MODEL

P emphasizes an advertising-focused business model, which hasn't produced any real operating leverage to date. P's efforts to increase monetization (ad load) is likely what's causing its rampant user attrition issue, which will ultimately cap the long-term potential of its model

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WEBCASTER IV PROCEEDING: P VS. SX

We will preview the scope of the proceeding and the relevant statutes. But we're not going to provide an all-encompassing summary of the proceeding. The key here is to focus on what really matters, which is collectively prior precedent and the proffered benchmarks.

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P's business model can't handle much more than a best case scenario (its proposal), and has likely lost the one debate that it can't (bifurcated rates). We're going to detail the range of outcomes to determine what P can actually handle before having to blow up its own model.

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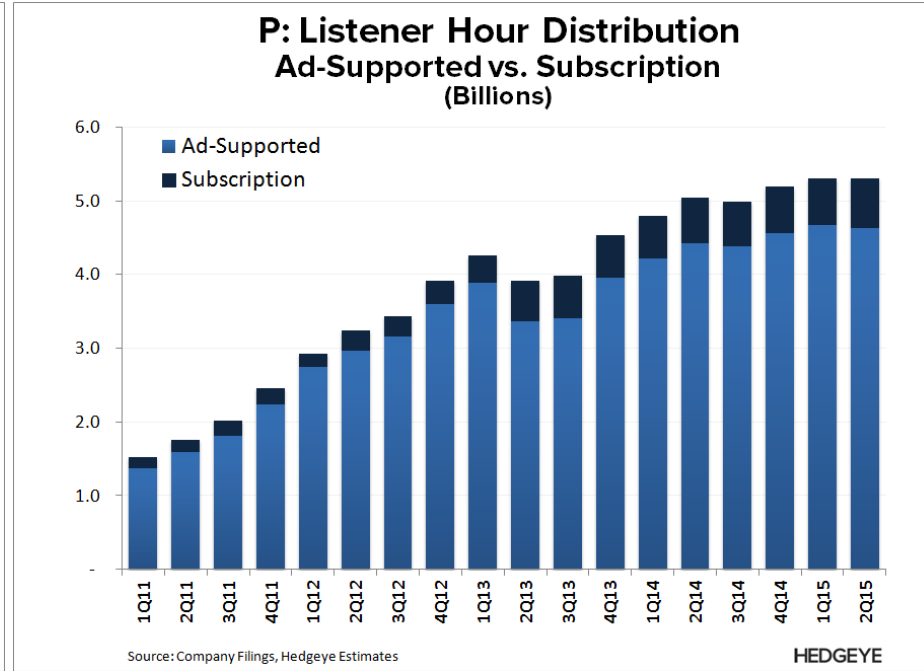
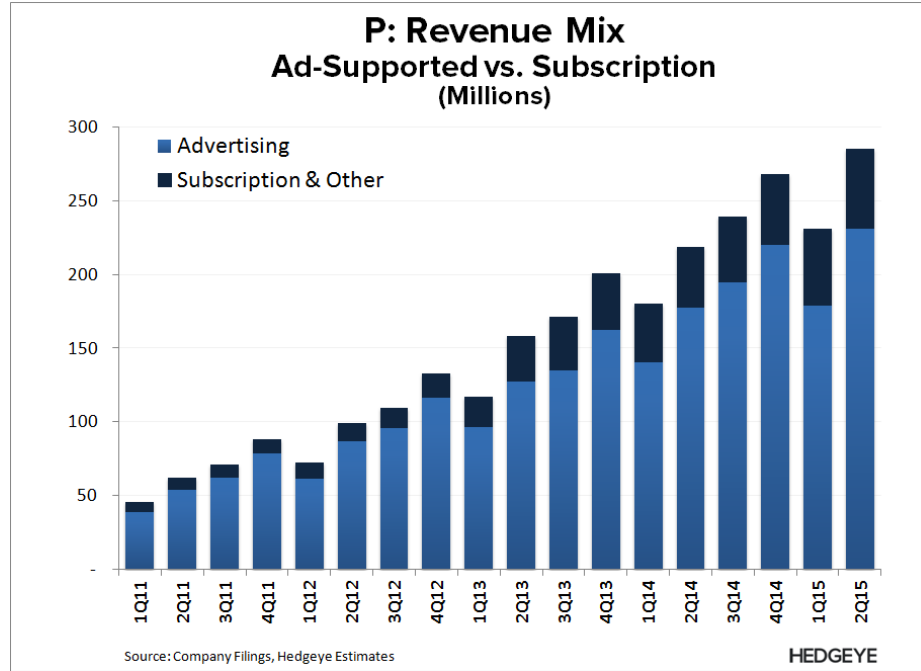
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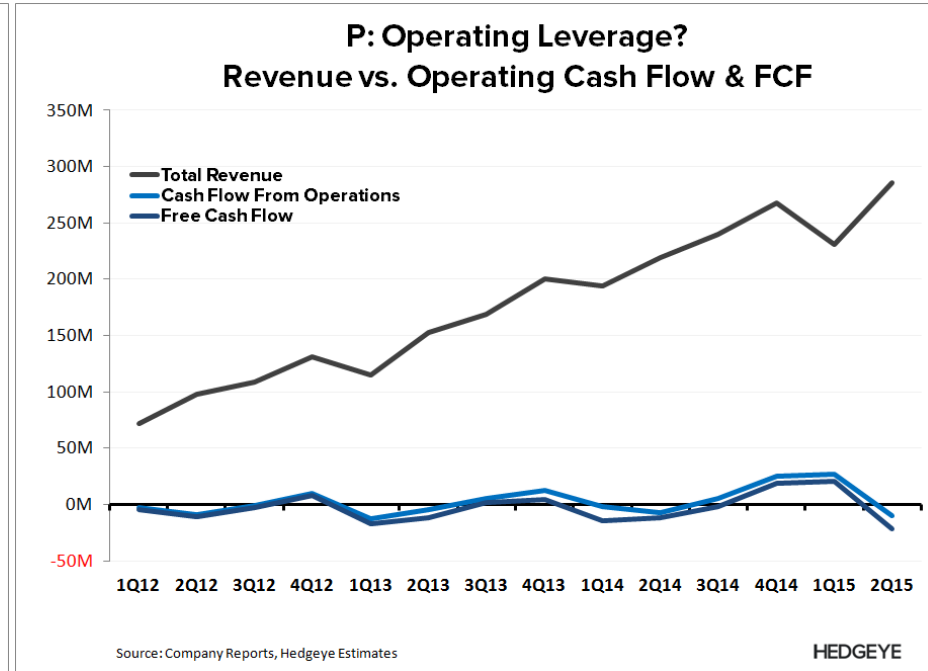
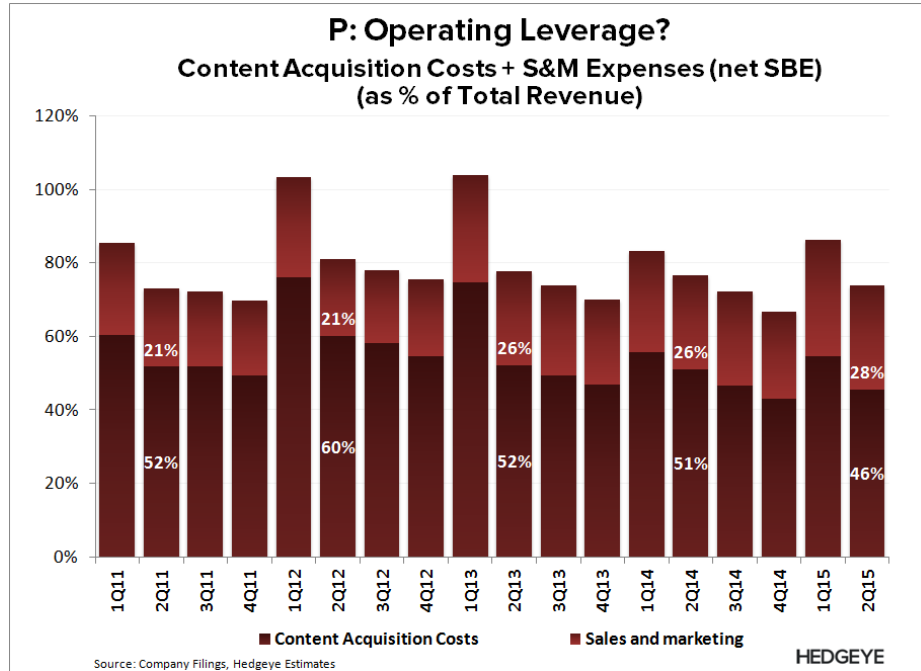
PRIORITY = AD-SUPPORTED MODEL...



P'S USERS FAVOR THE FREE PRODUCT, SO P'S MODEL FAVORS ADVERTISING

Nearly 90% of P's listener hours favor the free (ad-supported) service. There's nothing wrong with an ad-supported model, but it's a challenging model to run within this specific industry.

THAT CAN'T PRODUCE REAL LEVERAGE

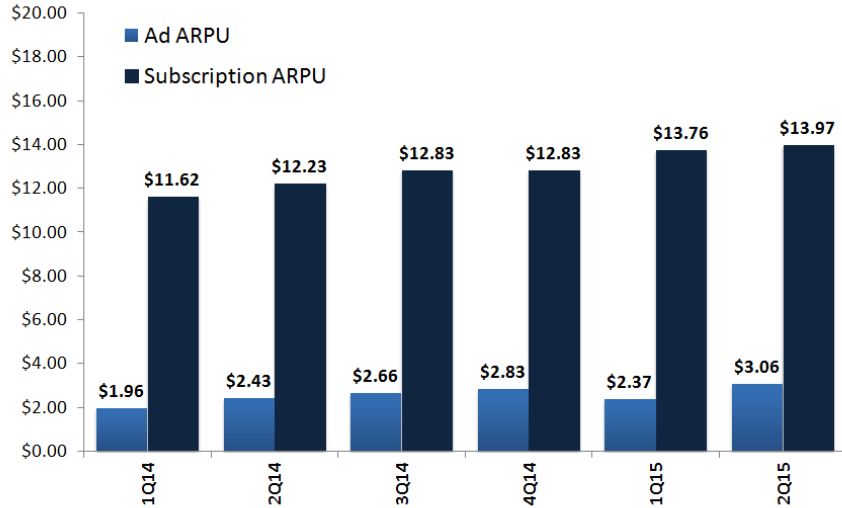


DESPITE THE CONVENTIONAL SELL-SIDE RHETORIC

Whatever leverage P has achieved on the content acquisition costs was paid for in salesforce & marketing expenses. Despite consistently rising revenue, P still struggles to generate consistent cash flow.

SINCE ADVERTISING LESS LUCRATIVE

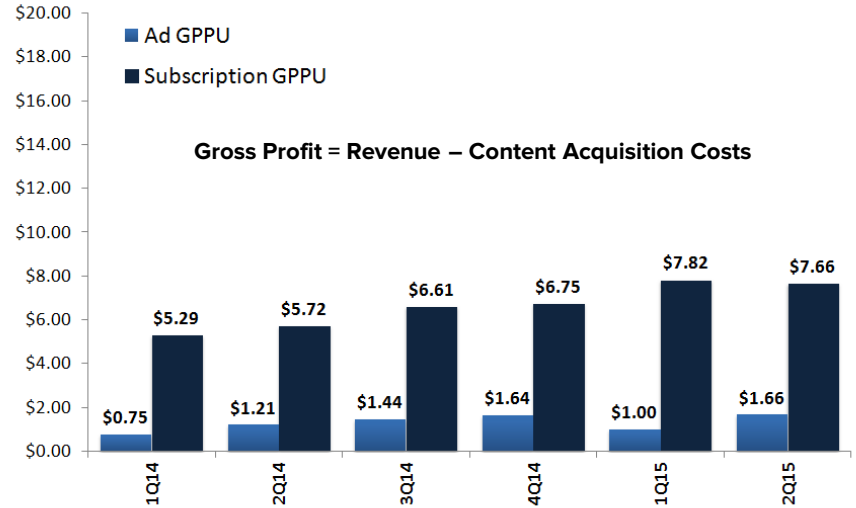
P: Average Revenue Per User (ARPU)
Ad-Supported vs. Subscription



Source: Company Filings, Hedgeye Estimates

HEDGEYE

P: Gross Profit Per User (GPPU)
Ad-Supported vs. Subscription



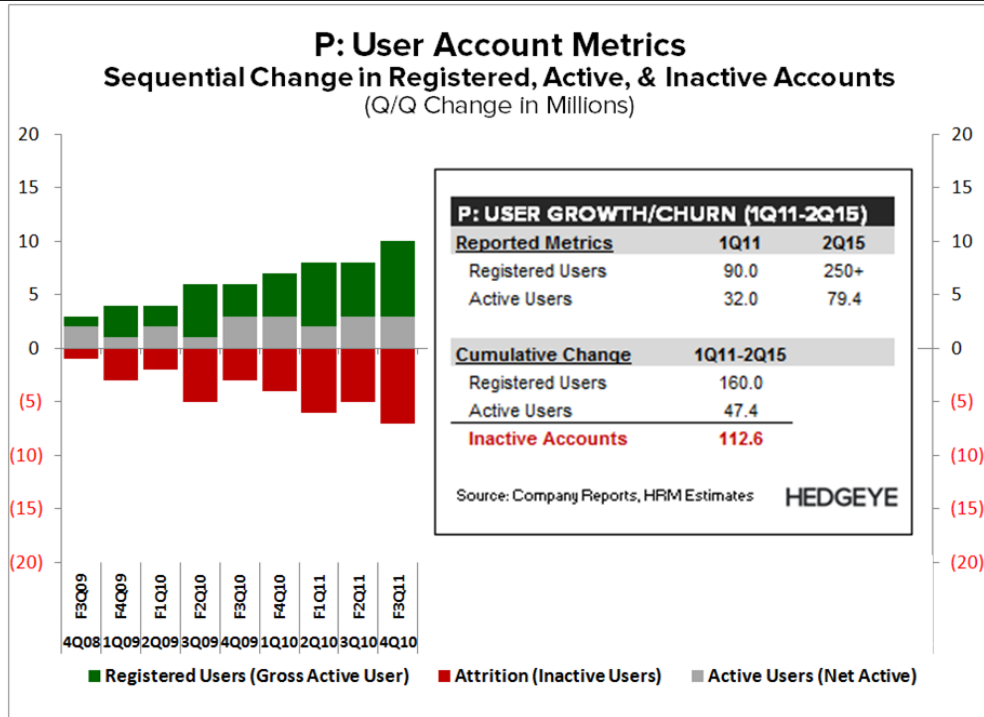
Source: Company Filings, Hedgeye Estimates

HEDGEYE

LOWER GPPU, DESPITE ROYALTY RATES THAT ARE ~40% LOWER THAN SUB RATE

The gross margin percentages are relatively the same. But the subscription business has a considerably higher ARPU, in turn, a much higher gross profit per user (GPPU). P is trying to increase Ad-supported ARPU, but

AND THOSE USERS EVEN LESS CAPTIVE



METRIC NOTES

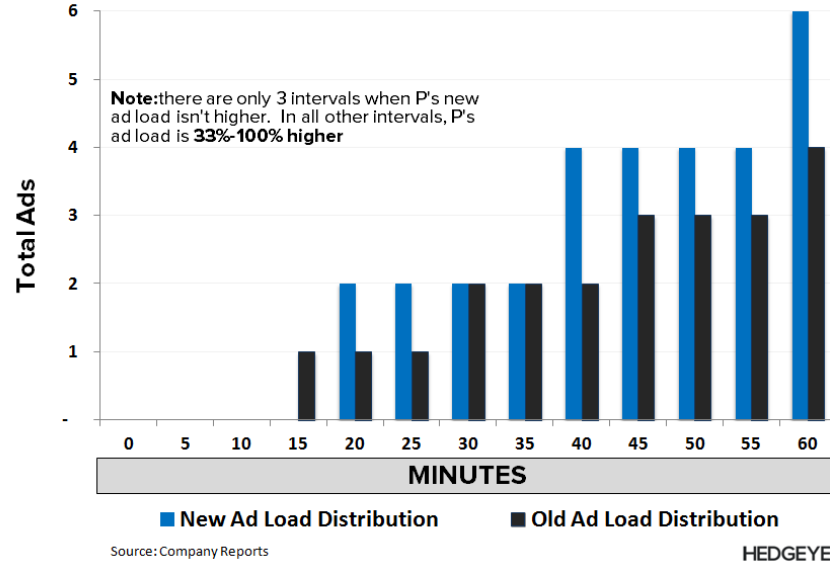
1. P switched its method for reporting registered users in 2Q11 (from an actual # to “#+” format)
2. We can't explicitly calculate its quarterly attrition rate after 1Q11, but we estimate it has averaged in the mid-to-high teens as percentage of its active users, or roughly 10.5M per quarter
3. We can calculate its cumulative attrition, which is at least 70% between 1Q11 and 2Q15 (~116M inactive out of 160M registered).

REPORTED METRICS TELL A DAUNTING STORY

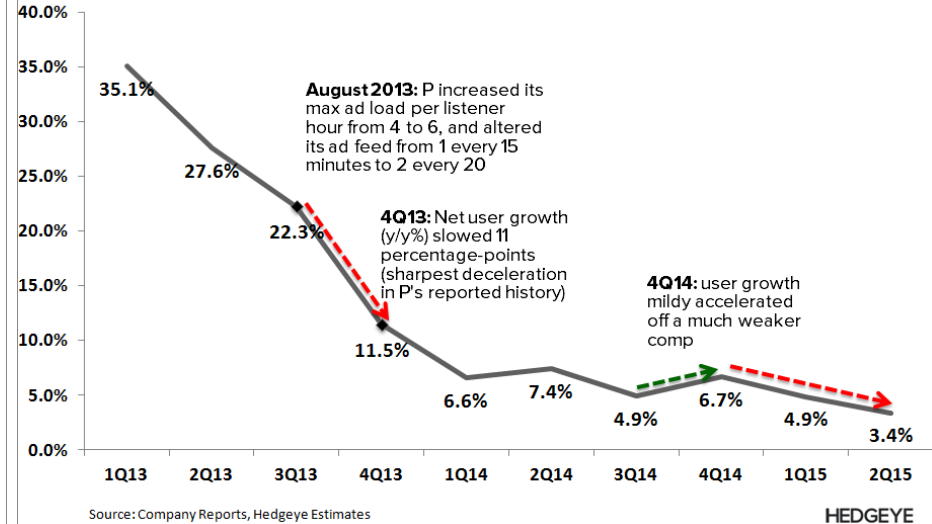
P's reported metrics suggest it has churned through more accounts than it has retained since 1Q11. Although P has a considerable number of duplicate accounts (according to our user survey), it can't explain its churn.

ESPECIALLY WHEN P RAMPS AD LOAD

P: Ad Load Distribution
Total Ads by Minutes Listened: New vs. Old



P: Rising Ad Load Pushing the User Away?
P: Ad-Supported Users
(Y/Y Growth %)



TANGIBLE EXAMPLE OF USER RESISTANCE TO INCREASING AD LOAD

We believe P's ad load is what is causing its churn. For context, the last time P considerably increased ad load, it led to the sharpest deceleration in Active Listeners in its reported history.

AND LESS GROWTH TO OFFSET CHURN

PANDORA US ADULT PENETRATION ANALYSIS

Cohort	US Internet Users ^{2,3}	P US User Penetration	P US Users	Accounts/ User	P US Accounts	Untapped TAM	% of Total
18-34	70,350	76%	53,780	1.68	90,237	16,570	17%
35-44	38,285	58%	22,246	1.65	36,809	16,040	17%
45-64	72,406	39%	28,243	1.65	46,689	44,163	46%
65+	25,032	26%	6,483	1.69	10,931	18,549	19%
Total (18+)	206,074	54%	110,752	1.67	184,667	95,322	100%

Internet Uptake/Smartphone Inflation³ **15%**
 Calculated Total US Internet Users³ **269,407**

PANDORA US NON-ADULT PENETRATION SCENARIO ANALYSIS (3-17 years old)

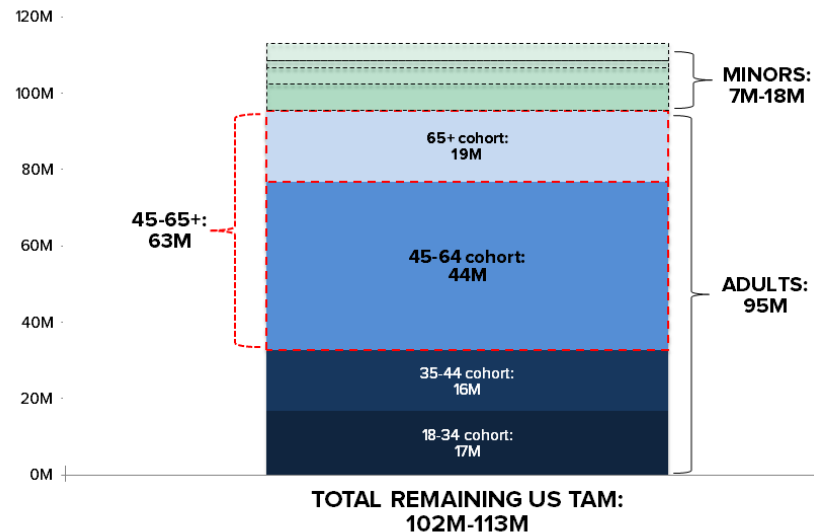
		Estimated Penetration/TAM			
		Acct/User	Users	Penetration	Untapped
P Total Registered Accounts	250,000	1.00	63,333	129%	n/a
P Adult US Accounts	184,667	1.25	50,666	103%	n/a
P International Accounts ⁴	2,000	1.50	42,222	86%	7,048
P Non-Adult US Accounts	63,333	1.67	37,924	77%	11,346
		1.75	36,190	73%	13,079
		2.00	31,666	64%	17,603
*Non-Adult US Internet Users ^{2,3}					49,270

Notes

- 1 All user metrics are in thousands (000s)
- 2 Internet User Data based on Census metrics for "Individual accesses the internet from some location"
- 3 We have inflated Census Internet User metrics to account for increased internet penetration since 2012 & users with smartphone-only access (Pew estimates 87% of US population accesses the internet)
- 4 Estimate based on management commentary

Source: Hedgeye Pandora User Survey (Aug 2014), Census, Company Reports, Pew Research **HEDGEYE**

Hedgeye Pandora Penetration Analysis: Remaining US TAM by Age Cohort



Source: Hedgeye Pandora User Survey, Company Reports, Census, Pew Research, Hedgeye Estimates

HEDGEYE

REMAINING TAM SKEWS MUCH OLDER, TOUGHER WILL BE TOUGHER TO

The table to the left is the marriage of our Aug 2014 P user survey (n=20K) with Census demographic internet user data. The key output to the right suggests that the bulk of P's remaining TAM is over 45 yrs old.

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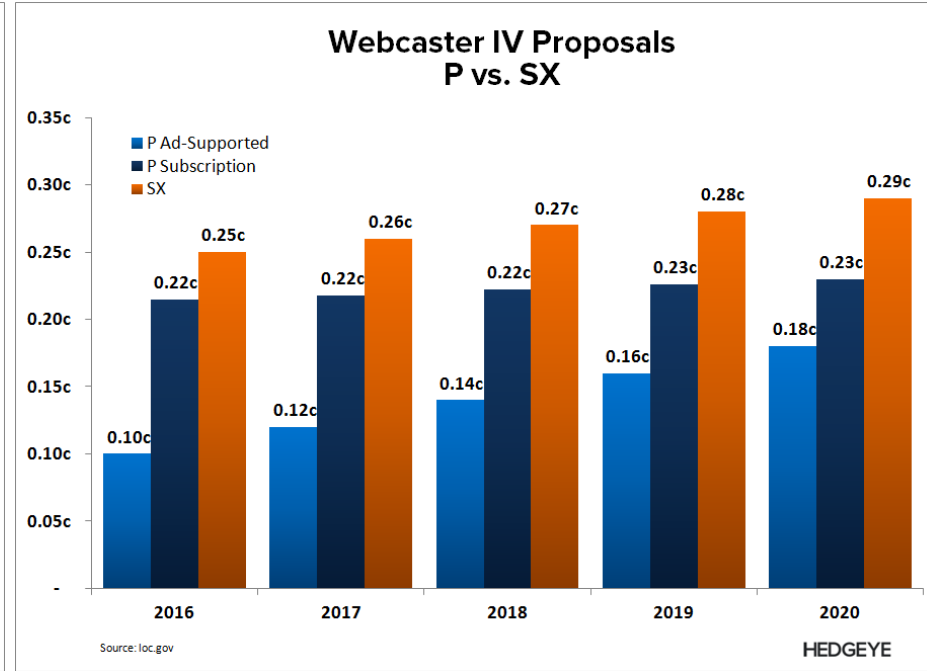
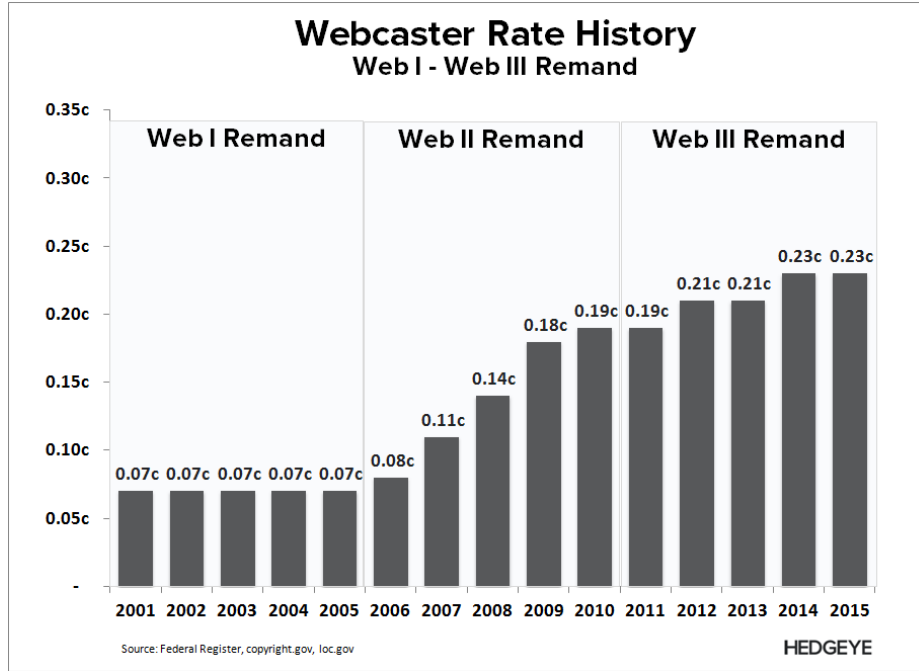
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PRIOR DECISIONS VS. PROPOSALS



SX ASKING FOR A STEADY INCREASE. P ASKING FOR A MAJOR RESET

Note that Webcaster rates have never declined, and have never distinguished by monetization strategy. So, the question is whether P can convince the Web IV judges to adopt a lower, bifurcated rate.

SO WHAT IS WEB IV?

- **Proceeding:**
 - The Copyright Royalty Board (CRB) convenes every 5 years to set royalty rates for **non-interactive streaming music** that both the **record labels and streaming services will be legally bound to** unless they can negotiate direct market agreements or WSA Settlement agreements (e.g. Pureplay Agreement) that are not precedential. **Web IV is for the 2016-2020 period.**
- **Purpose (Digital Millennium Copyright Act of 1998)**
 - *“To ensure that **recording artists and record companies will be protected as new technologies affect the ways in which their creative works are used**; and . . . to create **fair and efficient licensing mechanisms** that address the complex issues facing copyright owners and copyright users as a result of the **rapid growth of digital audio services**”*
(Web III Remand Judges quoting the Act)

THE ACT APPEARS TO FAVOR COPYRIGHT OWNERS OVER USERS

The key takeaway is that the Act is meant to protect artists and labels from evolving technologies. At the outset, it appears the labels have the upper hand to begin with

WHAT ARE THE KEY STATUTES?

- **Sections 114(f)(2) and 112(e)**
 - The CRB Judges must ***“Establish rates...that would have been negotiated in the marketplace between a willing buyer and a willing seller.”*** The judges are required to base their decision on “economic, competitive, and programming information presented by the parties” including
 - Whether webcasting may substitute for or promote a copyright owner’s revenue from sound recordings
 - Relative roles of copyright owner vs. transmitting entity in creative/technical contribution, capital investment, cost, and risk
 - **Direct agreements negotiated in the marketplace (i.e. benchmarks)**
- **Section 803(a)**
 - ***The Copyright Royalty Judges shall act in accordance with regulations issued by the Copyright Royalty Judges and the Librarian of Congress, and on the basis of a written record, prior determinations and interpretations of...and the Copyright Royalty Judges.***
- **Section 114(f)(5)(C)**
 - None of the provision of any settlement agreement between Sound Exchange and a Webcaster reached under the WSA (**e.g. the Pureplay Agreement**) ***“shall be admissible as evidence or otherwise taken into account in any administrative, judicial, or other government proceeding involving the setting or adjustment of the royalties”***

NOT A CUT-AND-DRY ANALYSIS, SO PRECEDENT IS KEY

The CRB judges are mandated to consider prior interpretations. Further, many of the arguments presented are subjective. **Note that the Web III Remand judges the same judges presiding over Web IV.**

WILLING BUYER/SELLER STANDARD?

The CRB Judges must “***Establish rates...that would have been negotiated in the marketplace between a willing buyer and a willing seller.***”

Prior Interpretations

- “The rates should be those that...would have agreed upon in a hypothetical marketplace that was not constrained by a compulsory license (Web I)
- “The “buyers” in this hypothetical marketplace are the Services...and this marketplace is one in which no statutory license exists (Web II Remand)
- “The Act instructs the Judges to use the willing buyer/willing seller construct, assuming no statutory license” (Web III Remand)
- The “willing seller/willing buyer” standard calls for rates that would have been set in a “competitive marketplace.” (Web I)
- The question of competition...whether market prices can be unduly influenced by sellers’ power or buyers’ power in the market (Web II Remand).
- The ‘willing seller/willing buyer’ standard calls for rates that would have been set in a ‘competitive marketplace.’” (Web III Remand quoting Web I)
- “Where the intent of Congress is to set a rate at fair market value, as in this proceeding, the Panel is not required to consider potential failure of those businesses that cannot compete in the marketplace (Web I)
- “A single market price...excludes buyers who cannot or will not pay the market price (and excludes sellers who cannot or will not accept the market price)” (Web III Remand)

THE POINT HERE IS THAT PRECEDENT CARRIES FORWARD

The Webcaster judges have generally interpreted the willing/seller construct comparably. And while all agree that rates must be competitive, that competition is not confined to only buyers vs. sellers.

WHAT MATTERS MOST?

- **Sections 114(f)(2) and 112(e)**

- The CRB Judges must ***“Establish rates...that would have been negotiated in the marketplace between a willing buyer and a willing seller.”*** The judges are required to base their decision on “economic, competitive, and programming information presented by the parties” including

- Whether webcasting may substitute for or promote a copyright owner’s revenue from sound recordings
- Relative roles of copyright owner vs. transmitting entity in creative/technical contribution, capital investment, cost, and risk

- **Direct agreements negotiated in the marketplace (i.e. benchmarks)**

Positions – Enumerated Factors

- **P:** “the rates and terms contained in proffered benchmarks already reflected the business judgments of licensors and licensees regarding the two factors enumerated in Sections 112(e)(4) and 114(f)(2)(B).”
- **SX:** “These factors “do not constitute additional standards, nor should they be used to adjust the rates determined by the willing buyer/willing seller standard.” *Web II Remand at 24087.* Instead, they “are merely to be considered, along with any other relevant factors, to determine the rates under the willing buyer/willing seller standard.” (Quoting the *Web II Remand Judges*)”
- **Web III Remand Judges:** “The adoption of an adjusted benchmark approach to determine the rates leads this panel to agree with *Web II* and *Web I* that such statutory considerations implicitly have been factored into the negotiated prices utilized in the benchmark agreements”

BENCHMARKS CARRY THE MOST WEIGHT

The common theme is that the enumerated factors are a secondary consideration, and are likely already captured in benchmark agreements. In short, subjective theoretical arguments carry less weight

WHAT ARE THE KEY BENCHMARKS?

1. **IHRT** = IHRT/WMG Deal
2. **SX** = Interactive Licenses
3. **P** = Merlin Deal

NOT ALL PARTICIPANTS, BUT ALL THAT REALLY MATTERS

Not all participants are directly vested in Commercial webcasting, and most have different priorities. This debate really centers on P vs. SX, but we'll briefly discuss of IHRT as well

IHRT: TERRESTRIAL POWER PLAY

1. IHRT = IHRT/WMG Deal

– Cluttered Benchmark

2. SX = Interactive Licenses

3. P = Merlin Deal

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Warner Music Group and Clear Channel Announce Landmark Music Partnership

Unprecedented Strategic Alliance to Help Break New Music and Enhance Artist Careers

WMG to Share In Revenue From All Platforms

New York, N.Y. – September 12, 2013 – Clear Channel Media and Entertainment and Warner Music Group Corp. (WMG) today announced a landmark partnership aligning the two companies' interests in driving digital growth, increasing radio listenership, breaking new music and creating new marketing opportunities for established artists. The agreement is the first wide-ranging strategic alliance between a major music company and Clear Channel.

Through this transformative alliance, WMG will share in revenue from all platforms and gain unprecedented opportunities to promote the music of its emerging and established artists across all of Clear Channel's unmatched multi-platform assets, including:

[All Press Releases](#)[Investors](#)[iHeartMedia](#)[Outdoor](#)[Corporate](#)[Philanthropy](#)

Related Articles

Big Machine Label Group and Clear Channel Announce Groundbreaking Agreement to Enable Record Company and Its Artists to Participate in All Radio Revenue Streams and Accelerate

WMG DEAL NOT A VALID BENCHMARK, SO THIS COMES DOWN TO P VS. SX

We believe IHRT's proposal is based on its WMG deal. But that also includes revenues from terrestrial radio, from which IHRT doesn't have to pay royalties to SX. Terrestrial is also not covered by the statutory license.

SX: INTERACTIVE BENCHMARK?

1. IHRT = IHRT/WMG Deal

- Cluttered Benchmark

2. SX = Interactive Licenses

- **Precedent = Valid**

3. P = Merlin Deal

Web II Remand: We find, based on the available evidence before us, that **the most appropriate benchmark agreements** are those reviewed by Dr. Pelcovits in the market for **interactive webcasting** covering the digital performance of sound recordings.

Web III Remand: The agreements between buyers and sellers in the **interactive market** are not expressly identified under the Act as agreements upon which the Judges may rely as benchmarks in a proceeding under section 114. However, **nothing in the Act suggests that it would be improper for the Judges to consider those agreements as potential evidentiary benchmarks, or as some other form of probative evidence.**

SOUNDS INAPPROPRIATE, BUT PRECEDENT SUGGESTS THE OPPOSITE

Webcaster proceedings are for setting rates in the non-interactive market. However, the adjusted interactive benchmark approach was accepted in both the Web II and Web III proceedings.

SX: BUT P CLAIMS UNCOMPETITIVE?

- IHRT = IHRT/WMG Deal
 - Cluttered Benchmark
- **SX = Interactive Licenses**
 - **Precedent = Valid**
- P = Merlin Deal



Office of the Director
Bureau of Competition

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Statement of Bureau of Competition Director Richard A. Feinstein
In the Matter of Vivendi, S.A. and EMI Recorded Music
September 21, 2012

limited selection of recorded music. Commission staff found considerable evidence that each leading interactive streaming service must carry the music of each Major to be competitive. Because each Major currently controls recorded music necessary for these streaming services, the music is more complementary than substitutable in this context, leading to limited direct competition between Universal and EMI. In the end, insufficient evidence existed showing that Universal and EMI offer products that could be viewed by streaming services as direct substitutes.

FTC APPEARS TO AGREE, SO P IS CORRECT TO A CERTAIN DEGREE...

P suggests the interactive benchmarks are uncompetitive, arguing that labels can charge higher monopoly/collusive oligopoly rates. While FTC appears to agree, it shops short of calling it non-competitive

SX: WHAT IS A COMPETITIVE MARKET?

- IHRT = IHRT/WMG Deal
 - Cluttered Benchmark
- **SX = Interactive Licenses**
 - **Precedent = Valid**
- P = Merlin Deal

Web III Remand Judges: “Between the extremes of a market with “metaphysically perfect competition” and a monopoly (or collusive oligopoly) market devoid of competition there exists “[in] the real world . . . a mind-boggling array of different markets,” Krugman & Wells, *supra*, at 356, **all of which possess varying characteristics of a “competitive marketplace.”**”



ANYTHING BETWEEN THE POLAR OPPOSITES

Just because the labels may have considerable market power, doesn't mean the interactive market is non-competitive. It just means one side has more power than the other, which is common in real-world negotiations

P: MERLIN = ONLY LEG TO STAND ON

- IHRT = IHRT/WMG Deal
 - Cluttered Benchmark
- SX = Interactive Licenses
 - Precedent = Valid
- **P = Merlin Deal**
 - **Derived from Statutory Rates (i.e. Pureplay Agreement)**

Willing Buyer/Seller Standard: Prior Interpretations

- “The rates should be those that...would have agreed upon in a hypothetical marketplace that was not constrained by a compulsory license (Web I)
- “The “buyers” in this hypothetical marketplace are the Services...and this marketplace is one in which no statutory license exists (Web II Remand)
- “The Act instructs the Judges to use the willing buyer/willing seller construct, assuming no statutory license” (Web III Remand)

P: “the rates and terms contained in proffered benchmarks already reflected the business judgments of licensors and licensees regarding the two factors enumerated in Sections 112(e)(4) and 114(f)(2)(B).”

P PUT ALL ITS CHIPS ON ITS ONLY BENCHMARK

The other deal is Naxos, which is too insignificant to matter. Since P has already argued that the enumerated factors (subjective arguments) are implicitly baked into market agreements, everything rides on Merlin

P: MERLIN DEAL LINKED TO PUREPLAY

- IHRT = IHRT/WMG Deal
 - Cluttered Benchmark
- SX = Interactive Licenses
 - Precedent = Valid
- **P = Merlin Deal**
 - **Derivative of Statutory Rates (Pureplay Agreement)**

KEY POINTS

1. Merlin is an **~18-month agreement** that **expires at the end of 2015**, which is when the **Pureplay Agreement expires**
2. SX Counsel: **“Numerous terms of the Pandora – Merlin agreement are copied verbatim from, or directly reference, the Pureplay agreement.”**
3. Charlie Lexton [Merlin negotiator] stated that **“the effective compensation is, at worst, no lower than compensation under the existing statutory rates paid by Pandora.”** He also suggested that a specific term of the deal **“is dependent on Pandora eligibility for the Pureplay rates”**.
4. Pandora Counsel suggests that the Merlin deal offered Pandora a **“discount off the rates in the Pureplay Agreement”**
5. Pandora Counsel: **“all of the agreements under consideration...are influenced to some degree by the prevailing statutory rates (including the Pureplay rates)”**
6. **Pandora** is the only major Service in this proceeding **that could have and did opt into the Pureplay Agreement** due the included % of **Gross Revenue prong**.

IT'S HARD TO DRAW ANY OTHER CONCLUSION

Point 5 & 6 are crucial. P is conceding that Merlin was influenced by the Pureplay agreement, but P is also the only major Service that could have fallen back on the Pureplay agreement if it couldn't negotiate a direct deal.

P: BUT WASN'T MERLIN APPROVED?

- IHRT = IHRT/WMG Deal
 - Cluttered Benchmark
- SX = Interactive Licenses
 - Precedent = Valid
- **P = Merlin Deal**
 - **Derivative of Statutory Rates**
(Pureplay Agreement)

TIMELINE

1. **June 19th**: SX argued within its Proposed Conclusions of Law and Findings of Fact that the P-Merlin Deal was inadmissible and should be thrown out
2. **July 29th 2015**: The CRB judges asked the Copyright Register whether it is barred from considering a license agreement if **it includes any terms** that were **copied verbatim, substantially identical, influenced by, or refers to a WSA agreement (e.g. Pureplay)**. The Register had one month to reply after the last submission from the Parties on the matter (Aug 14th)
3. **September 18th 2015**: The Register ruled in favor P suggesting that the Merlin deal is admissible. **But**, the Register also ruled that the **Pureplay** agreement is also **admissible as evidence to assess its impact on the Merlin deal**.
4. **December 15th 2015**: Deadline for the final Web IV decision

IT WASN'T APPROVED OR ENDORSED...IT JUST WASN'T THROWN OUT

The Register's decision is **not a preliminary victory for P**, it just means that P hasn't lost yet. Merlin is admissible, but will be tested for influence of the Pureplay Agreement (see prior two slides).

P: WEB IV PRESENTATION OUTLINE

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P emphasizes an advertising-focused business model, which hasn't produced any real operating leverage to date. P's efforts to increase monetization (ad load) is likely what's causing its rampant user attrition issue, which will ultimately cap the long-term potential of its model

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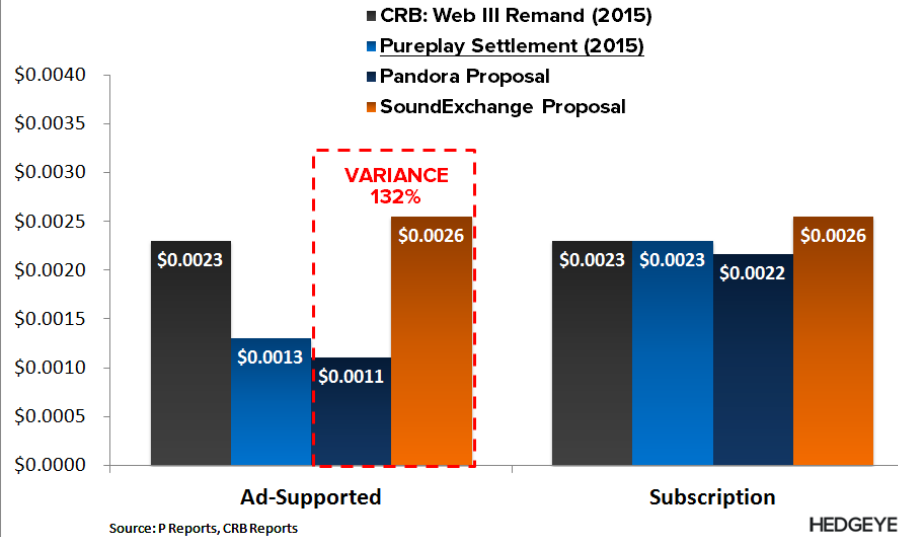
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P LOST THE KEY WEB IV DEBATE

**Current Music Licensing Rates
vs. P & SoundExchange Proposals
(2016-2017: average rate per song)**



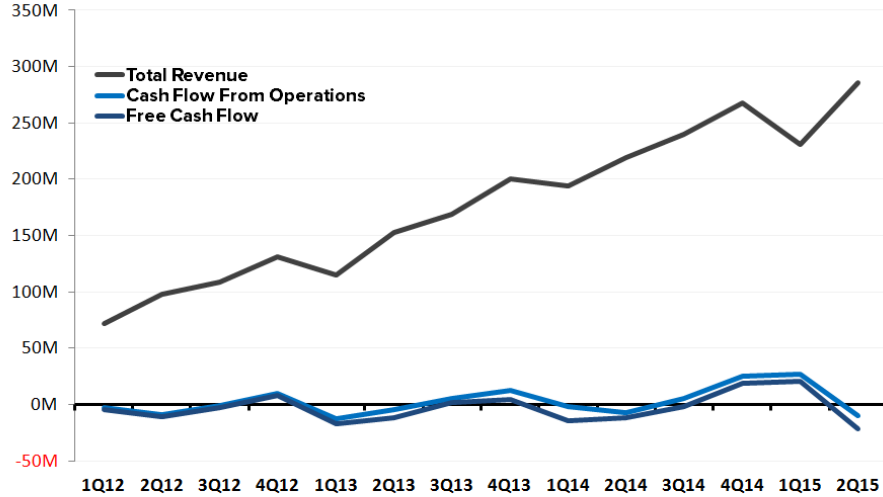
1. **Pureplay Settlement is Irrelevant:** The current bifurcated rate setup was borne out of the Pureplay Agreement, which legally can never be used as a benchmark in any rate-setting procedure.
2. **Merlin is Irrelevant:** For all the reasons we just laid regarding Pureplay Agreement's statutory influence on Merlin, it will be very hard to imagine the CRB judges adopting P's proposed rate structure. For context, P is the only major service asking for a bifurcated rate setup.
3. **P's Business Model is Irrelevant:** "The normal free market processes typically weed out those entities that have **poor business models** or are inefficient. To allow **inefficient market participants** to continue to use as much music as they want and for as long a time period as they want **without compensating** copyright owners on the **same basis as more efficient market participants** trivializes the property rights of copyright owners" (Web II Remand judges discussing a proposed rate structure)

BIFURCATED RATE STRUCTURE: NO LEG TO STAND ON

P hasn't done anything to prove it proposed rate structure reflects what willing buyers/sellers would agree to outside the shadow of statutory rates. Further, P's business model is a secondary concern at best.

RATE INCREASE TOUGH TO ABSORB

P: Operating Leverage?
Revenue vs. Operating Cash Flow & FCF

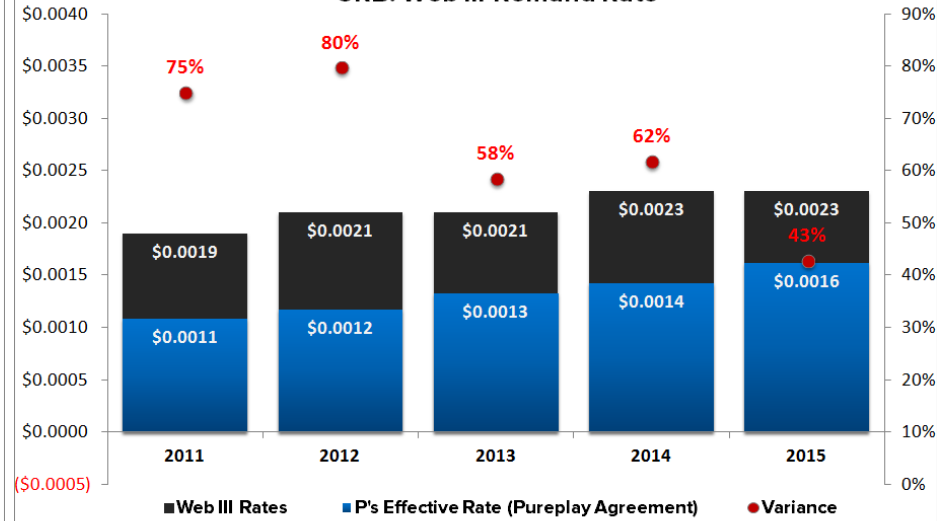


Source: Company Reports, Hedgeye Estimates

HEDGEYE

P: Big Variance Between Effective & CRB Rates

Effective Rate: Weighted-Average Pureplay Rate
CRB: Web III Remand Rate



Source: CRB, Hedgeye Estimates (P's Effective Rate)

HEDGEYE

NO REAL LEVERAGE IN P'S MODEL...EVEN UNDER THE LOWER PUREPLAY RATES

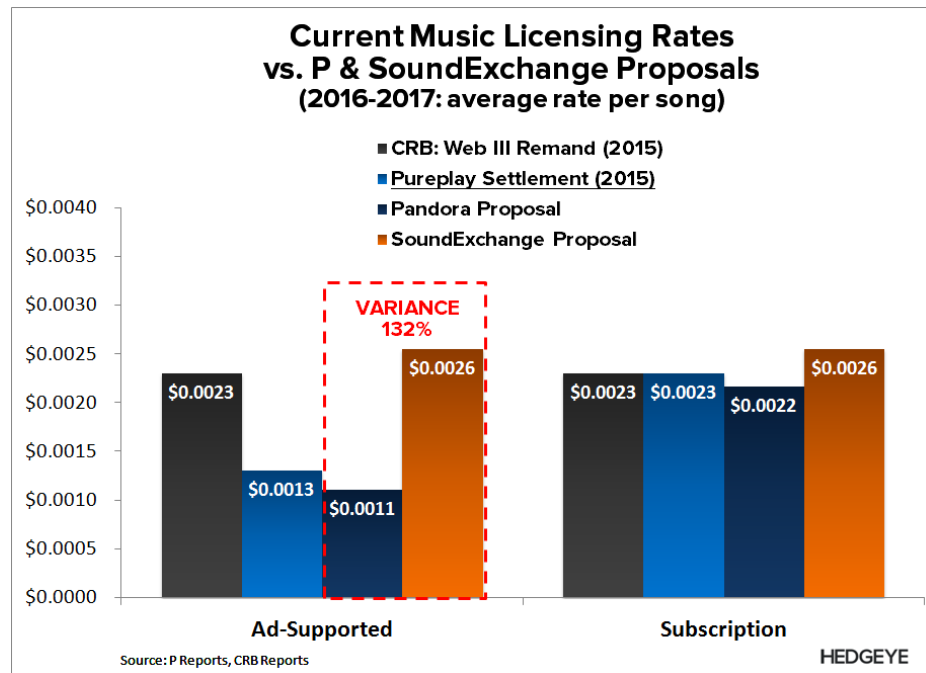
The CRB will likely rule for a single per-play rate (as it always has) since P doesn't have a basis for a bifurcated rate structure. P's effective rate will spike since ad-supported tracks will no longer receive preferential rates.

SO WHAT'S THE FALLOUT?

P: WEB IV SCENARIO ANALYSIS: TOTAL EBITDA (2016-2017)							
WEB IV RATE VS. HOURS (2016-2017 CAGR)							
SCENARIO: Consensus Revenue CAGR (2016-2017): 22%							
Web IV Rates	Listener Hours						
	7.5%	10.0%	12.5%	15.0%	17.5%	20.0%	20.0%
\$0.00260	(\$118M)	(\$182M)	(\$247M)	(\$314M)	(\$381M)	(\$449M)	(\$449M)
\$0.00250	(\$49M)	(\$110M)	(\$173M)	(\$237M)	(\$301M)	(\$367M)	(\$367M)
\$0.00240	\$21M	(\$39M)	(\$99M)	(\$160M)	(\$222M)	(\$285M)	(\$285M)
\$0.00230	\$90M	\$33M	(\$25M)	(\$83M)	(\$142M)	(\$203M)	(\$203M)
\$0.00220	\$159M	\$105M	\$50M	(\$6M)	(\$63M)	(\$121M)	(\$121M)
\$0.00210	\$228M	\$177M	\$124M	\$71M	\$16M	(\$39M)	(\$39M)
\$0.00200	\$298M	\$248M	\$198M	\$147M	\$96M	\$43M	\$43M
\$0.00190	\$346M	\$320M	\$273M	\$224M	\$175M	\$125M	\$125M
\$0.00180	\$379M	\$365M	\$347M	\$301M	\$255M	\$207M	\$207M
\$0.00170	\$401M	\$399M	\$386M	\$373M	\$334M	\$289M	\$289M

Source: P reports, CRB Filings, Hedgeye Estimates

HEDGEYE



THE TAKEAWAY IS NOT THE RED, BUT WHAT P NEEDS TO GET INTO THE GREEN

We're not making waves by suggesting that P's model can't survive SX's proposal or even the Web III rates. The takeaway is that P will need to find a way to **maximize revenues while limiting hours (and its other costs)**.

EXTREMELY SENSITIVE SITUATION

P: WEB IV SCENARIO ANALYSIS: TOTAL EBITDA (2016-2017)							
WEB IV RATE VS. HOURS (2016-2017 CAGR)							
SCENARIO: Consensus Revenue CAGR (2016-2017) 22%							
Web IV Rates	Listener Hours						
	7.5%	10.0%	12.5%	15.0%	17.5%	20.0%	20.0%
\$0.00260	(\$118M)	(\$182M)	(\$247M)	(\$314M)	(\$381M)	(\$449M)	(\$449M)
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\$0.00230	\$90M	\$33M	(\$25M)	(\$83M)	(\$142M)	(\$203M)	(\$203M)
\$0.00220	\$159M	\$105M	\$50M	(\$6M)	(\$63M)	(\$121M)	(\$121M)
\$0.00210	\$228M	\$177M	\$124M	\$71M	\$16M	(\$39M)	(\$39M)
\$0.00200	\$298M	\$248M	\$198M	\$147M	\$96M	\$43M	\$43M
\$0.00190	\$346M	\$320M	\$273M	\$224M	\$175M	\$125M	\$125M
\$0.00180	\$379M	\$365M	\$347M	\$301M	\$255M	\$207M	\$207M
\$0.00170	\$401M	\$399M	\$386M	\$373M	\$334M	\$289M	\$289M

Source: P reports, CRB Filings, Hedgeye Estimates

HEDGEYE

P: WEB IV SCENARIO ANALYSIS: TOTAL EBITDA (2016-2017)							
WEB IV RATE VS. HOURS (2016-2017 CAGR)							
SCENARIO: Revenue CAGR (2016-2017) 18%							
Web IV Rates	Listener Hours						
	7.5%	10.0%	12.5%	15.0%	17.5%	20.0%	20.0%
\$0.00260	(\$194M)	(\$258M)	(\$323M)	(\$389M)	(\$456M)	(\$524M)	(\$524M)
\$0.00250	(\$124M)	(\$186M)	(\$249M)	(\$312M)	(\$377M)	(\$442M)	(\$442M)
\$0.00240	(\$55M)	(\$114M)	(\$174M)	(\$235M)	(\$297M)	(\$360M)	(\$360M)
\$0.00230	\$14M	(\$42M)	(\$100M)	(\$158M)	(\$218M)	(\$278M)	(\$278M)
\$0.00220	\$84M	\$29M	(\$26M)	(\$82M)	(\$138M)	(\$196M)	(\$196M)
\$0.00210	\$153M	\$101M	\$49M	(\$5M)	(\$59M)	(\$114M)	(\$114M)
\$0.00200	\$222M	\$173M	\$123M	\$72M	\$20M	(\$32M)	(\$32M)
\$0.00190	\$292M	\$245M	\$197M	\$149M	\$100M	\$50M	\$50M
\$0.00180	\$350M	\$317M	\$272M	\$226M	\$179M	\$132M	\$132M
\$0.00170	\$383M	\$370M	\$346M	\$303M	\$259M	\$214M	\$214M

Source: P reports, CRB Filings, Hedgeye Estimates

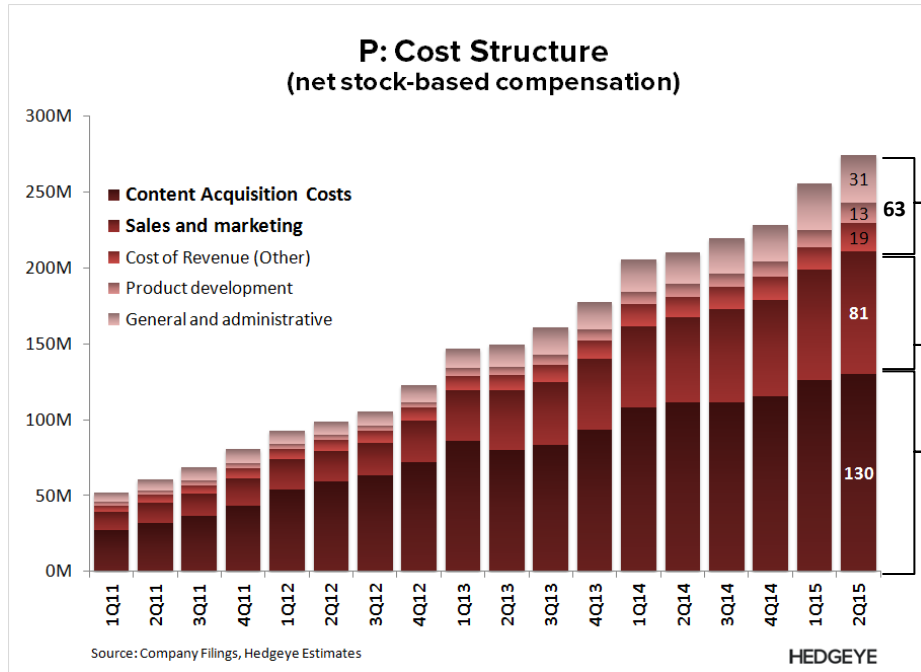
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Note: Both scenarios assume all other costs at an identical percentage of revenue, implying that P has the ability to respond to revenue shortfalls by cutting cost elsewhere (see next slide)

THERE IS LIMITED WIGGLE ROOM FOR P TO GET THIS RIGHT

The original scenario analysis is based off of consensus revenue CAGR of 22% through 2017. The scenario the right is based of an 18% CAGR. Small variances in revenue growth = very big difference in profitability

WITH LIMITED WAYS TO OFFSET



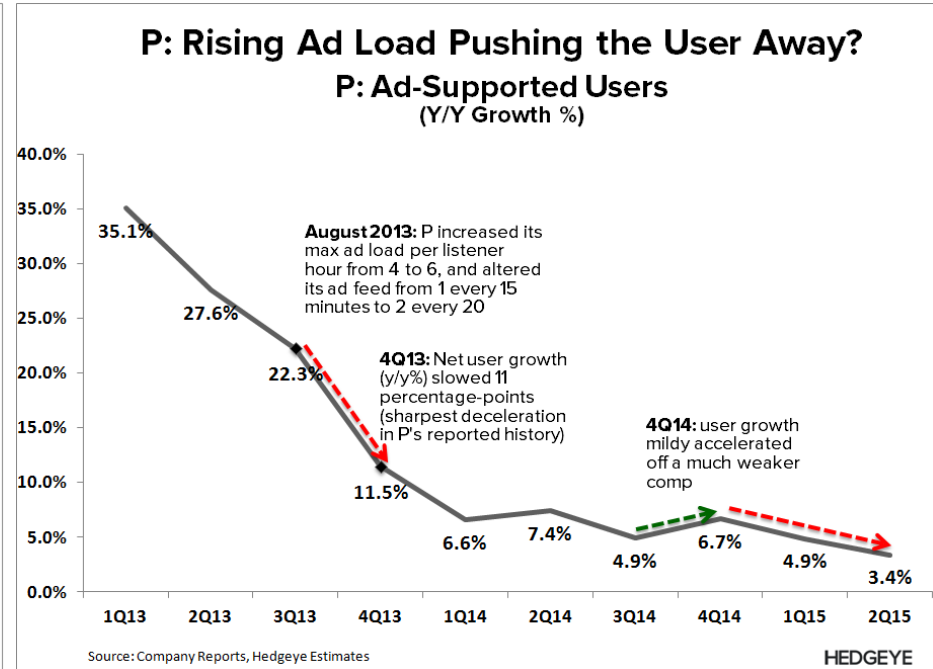
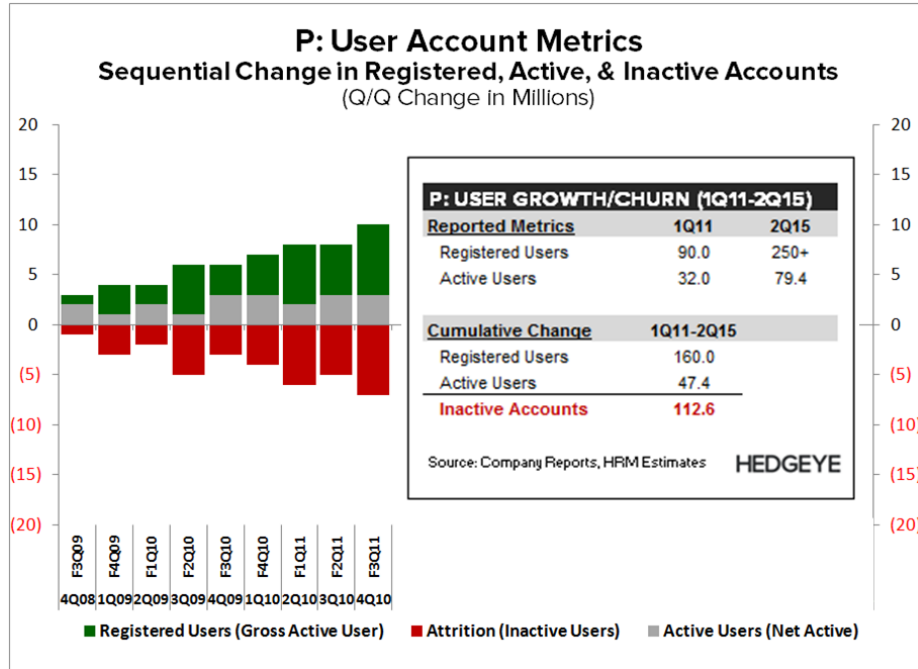
Where Could P Trim if Revenues Fall Short?

- 1. Other Operating:** ~23% of operating expenses. Could trim here, but likely not enough to offset royalty rate increases (too small)
- 2. Sales & Marketing:** ~29% of operating expenses. P could trim its salesforce, but that limits revenue growth prospects
- 3. Content Acquisition Costs:** ~48% of operating expenses. The only thing P could trim here is hours since the royalty rate is legislated. But that limits available inventory and/or increases per-hour ad load.

WITHOUT COMPROMISING ITS ENTIRE MODEL

All realistic options lead to a delicate situation that ultimately cap revenues. If P cuts S&M, the local growth opportunity dies with it. If P cuts hours, its ability to place ads is compromised since...

P ALREADY HAS A CHURN PROBLEM



INCREASING PER-HOUR AD LOAD WILL ONLY MAKE IT WORSE

Trying to drive revenue growth off fewer hours means increasing per-hour ad load, which is could exacerbate its attrition issues. We've seen this play out before.

P'S MODEL CAN'T SURVIVE WEB IV

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Source: P reports, CRB Filings, Hedgeye Estimates

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P's Model in a Post-Web IV World

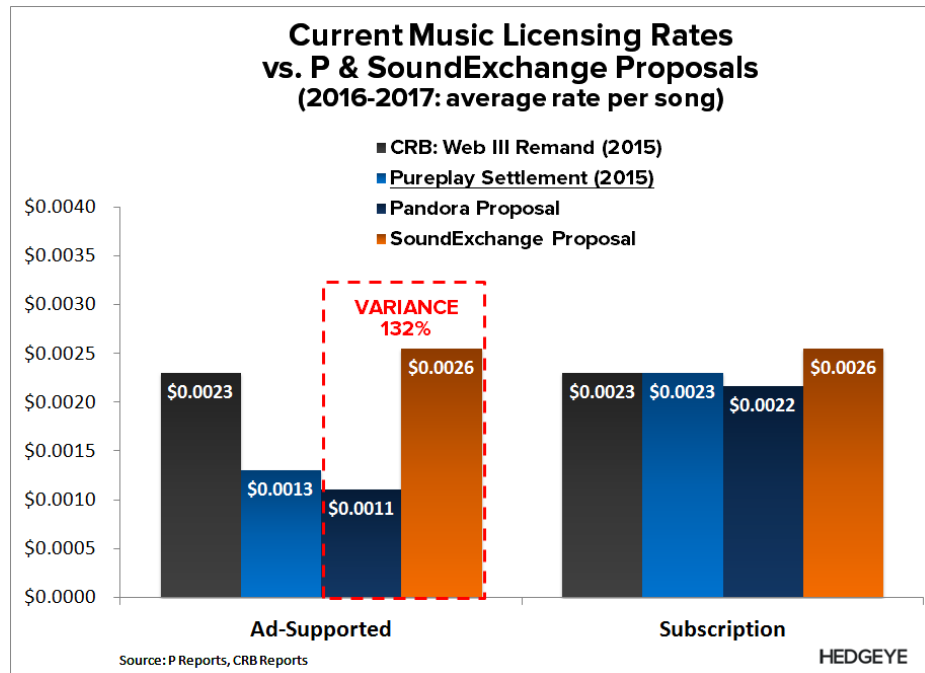
1. Extremely Sensitive to its Revenues
2. Limited Avenues to Cut Costs without putting its Revenues at Risk
3. Declining Hours = Lost Ad Inventory and/or Increasing Per-hour Ad Load, which could Exacerbate Attrition

THE RISK OF SHOOTING FOR GREEN IS VERY RED

We all need to be careful when assessing the impact of Web IV on P. It's not just the ultimate rate that matters. It's that P's model offers limited wiggle room to get it right, and the fallout of getting wrong could be disastrous.

P: WEBCASTER IV = POWDER KEG

1. **Business Model:** Advertising-focused model. P must pay for every song it streams, regardless of whether it is serving ads to those listener hours.
2. **Analysis:** P hasn't achieved any material operating leverage to date. P's efforts to increase monetization have led to rampant user attrition.
3. **Outlook:** We expect P to lose the one Web IV debate that it can't (bifurcated royalty rates). P's model can't handle much more than a best case scenario.
4. **Setup:** Web IV will be decided sometime in December, but the Street believes P received a preliminary victory already (it didn't)
5. **Short Duration:** Exit between 4Q15 and 1H16



CHALLENGING BUSINESS MODEL, WHICH MAY NOT SURVIVE WEB IV

P is running an ad-focused business model, which has yet to produce any meaningful profitability despite discounted Pureplay rates. P's model is only sustainable if it gets its way on Web IV; that doesn't appear likely

FOR MORE INFORMATION, CONTACT US AT:

SALES@HEDGEYE.COM

(203) 562-6500