Pandora gains point to healthy Internet IPO future

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Joe Kennedy, third from left, CEO & President, and Tim Westergren, fourth from left, Chief Strategy Officer & Founder, of Pandora internet radio, ring the NYSE opening bell to celebrate their company's IPO at the New York Stock Exchange Wednesday, June 15, 2011. (AP Photo/Richard Drew)

(AP) -- Internet radio station Pandora Media's IPO struck the right chord with investors Wednesday despite the static in the overall stock market.

Pandora's stock surged by as much 63 percent in their market debut before pulling back later in the session. The shares closed at $17.42, still a decent gain amid the market's broader decline. It marked a 9 percent increase from Pandora's initial public offering price of $16 and a nearly six-fold increase from what Pandora's own board thought the stock was worth just six months ago.

The performance shows the recent market slump hasn't dampened the enthusiasm investors have for new stock offerings from rapidly growing Internet services.

The excitement began to build after shares of professional networking site LinkedIn Corp. more than doubled on their first day of trading last month. Now it looks like the fervor could escalate into an outright mania as even bigger Internet companies such as online coupon seller Groupon Inc., Web game maker Zynga and the biggest star of all, Facebook, go public during the next year or so.

"Everyone seems to be getting gold-rush fever," said analyst Phil Leigh of Inside Digital Media. "People are starting to believe they can find gold in every stream or around every hill, but that's not the reality."

Pandora CEO Joseph Kennedy said he won't allow his 360-employee company to get caught up in the hysteria. "I am not jumping up and down right now," Kennedy said in a Wednesday interview. "I just see this as another step toward building a great company."

Kennedy, 51, owns 4.2 million Pandora shares, a stake now worth about $74 million.

The warm Wall Street reception for Pandora pegged the company's market value at $2.8 billion. That's already more than the $2 billion market value of AOL Inc., an Internet pioneer hailed as a next great media powerhouse at the height of the dot-com boom 11 years ago.

Around the same time, Pandora was just starting out as a music recommendation company then known as Savage Beast Technologies.

Pandora adopted its current name in 2005 when it morphed into a new type of radio station that streams music over the Internet. What makes

Pandora different from broadcast radio is that it can employ computer formulas to learn each of its individual listeners' tastes in order to create personalized song lists.

The concept has been a hit with music lovers, helping Pandora build an audience of 94 million registered users who mostly listen to the service on home and office computer and mobile phones. The company, based in Oakland, Calif., is now striking deals to supplant traditional radio stations in cars, just as satellite service Sirius XM Radio Inc. already has done.

Unlike the subscription-driven Sirius, Pandora gets about 85 percent of its revenue from advertising. The rest of its revenue comes from subscribers who pay $36 annually to hear higher-quality sound without commercial interruptions.

Pandora's biggest problem so far has been that its revenue is not growing fast enough to cover the royalties that it pays to play music. Those rates go up as Pandora attracts more listeners.

Pandora has suffered an uninterrupted string of losses totaling $92 million in its short lifetime, including a $6.8 million loss during the first three months of its current fiscal year before accounting for dividends on preferred stock.

"Unless they can continue to increase their subscribers or offer new material, obviously their losses will continue to grow," predicted Scott Sweet, managing partner of IPOboutique.com.

But Pandora's revenue is rising rapidly, more than doubling in its fiscal first quarter to $51 million. If it can maintain that growth pace, Pandora's revenue for the fiscal year ending next January would be about $325 million.

That means Pandora's market value stands at 8.5 times its projected revenue. By comparison, Sirius' market value of $7.7 billion is about 2.5 times its anticipated revenue for this year.

Pandora also is facing potential competitive threats from some of technology's most powerful companies. Apple Inc., Google Inc., and Amazon.com Inc. all are offering to store people's personal music collections on remote computers so the songs can be played on any device with an Internet connection. It wouldn't be a surprise if any of those three companies expanded their music offerings to include a music recommendation service similar to Pandora's, said analyst Martin Pyykkonen of Wedge Partners.

"There isn't a big barrier to entry in this market," Pyykkonen said.

Similar worries dogged Netflix Inc.'s video subscription service when the company went public in 2002. Many analysts thought Netflix would eventually be crushed by video rental store chain Blockbuster Inc. or another larger company such as Amazon.com or Wal-Mart Stores Inc., which once ran a competing DVD-by-mail service.

Blockbuster went bankrupt, Wal-Mart retreated from DVD-by-mail services and Amazon still hasn't come up with a way to counter Netflix. Anyone who bought $10,000 worth of Netflix's stock at its IPO price and held on to it would have a paper gain of about $330,000 so far.

The skepticism about Pandora's prospects may be one reason the company's shares didn't soar as high as LinkedIn's did. LinkedIn stock more than doubled from its IPO price in its first day of trading on May 19 to close at $94.25. The shares have since fallen more than 20 percent, closing Wednesday at $74.62. That's still well above the $45 IPO price.

There's another possible reason Pandora's shares didn't rise as much: the company's investment bankers were more aggressive about raising the IPO price. Two weeks ago, the IPO price had been set at $7 to $9 per share before strong demand drove it up. After expenses, Pandora expects to get $85.5 million from selling 6 million shares in the IPO. Company insiders told a combined 8.7 million shares to cash out $139 million for themselves.

The current value of Pandora's stock looks even more impressive, given the company's board appraised the shares value at $3.14 in early December last year, according to documents filed with the Securities and Exchange Commission.

Pandora's IPO also came in a rockier stock market than LinkedIn's did.

A rash of ugly reports on the economy has helped push stock indexes down for six straight weeks, its worst stretch since 2008. Since LinkedIn completed its IPO, the tech-driven Nasdaq composite index has fallen more than 6 percent.

Internet IPOs, though, could still look attractive to investors desperately looking for bright spots amid the gloom.

"Companies like Pandora are growing despite the slow-growing economy," said Kathleen Smith, a principal at Renaissance Capital, an IPO investment adviser. "That's why investors have turned to them."

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