CASE 11

Sirius XM Satellite Radio Inc. in 2014: On Track to Succeed after a Near-Death Experience?

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In February 2009, the outlook for Sirius XM Satellite Radio was grim. Despite having 2008 revenues of nearly $1.7 billion and some 19 million subscribers, the company's stock price had dropped to a low of $0.05 per share, and the company was mired in a deep financial crisis, with debts totaling more than $3 billion. Years of big spending and annual losses in the hundreds of billions had depleted the company's ability to secure additional credit to pay its bills, and the company lacked the cash to make a scheduled debt payment of $171.6 million due on February 17. But hours before filing for Chapter 11 bankruptcy (in order to avoid defaulting on the scheduled debt payment), Sirius XM got a lifeline from Liberty Media, a $2 billion company with business interests in the media, communications, and entertainment industries; Liberty was headed by cable TV pioneer and financial tycoon John Malone, who not only owned a controlling interest in Liberty Media but also was known for making big investments in troubled or undervalued companies having what he believed were good prospects for long-term profitability. Liberty agreed to provide an aggregate of $530 million in loans to Sirius in return for (1) 12.5 million shares of Sirius XM preferred stock convertible into 40 percent of common stock of Sirius XM and (2) seats on the Sirius XM board of directors proportional to its equity ownership. Two of these seats were to be occupied by John Malone, Liberty's chairman, and Greg Maffei, Liberty's CEO. Many outsiders viewed the terms to be a sweetheart deal for Liberty Media.

Headed into 2014, Sirius XM had 25.6 million subscribers, 2013 revenues of $3.8 billion, operating income of $1 billion, net income of $377 million, and cash flows from operations of $1.1 billion. The company's stock price had rebounded nicely and traded mostly in the $3.50 to $4 range during the last three months of 2013, equal to a market capitalization of $21 billion to $24 billion.

COMPANY BACKGROUND

Sirius XM Satellite Radio was the product of a 2008 merger of Sirius Satellite Radio and XM Satellite Radio. The two predecessor companies had begun operations in 2001–2002, spending hundreds of millions to launch satellites for broadcasting signals, arrange for the manufacture of satellite radio receivers and other equipment, install terrestrial signal repeaters and other necessary networking equipment, develop programming, conduct market research, and attract subscribers. The primary target market for satellite radio service included the owners of the more than 230 million registered vehicles in North America and, secondarily, the over 120 million households in the United States and Canada.

Market research done in 2000–2001 indicated that as many as 49 million people might subscribe to satellite radio service by 2012, assuming a monthly fee of $9.95 and radio receiver prices of $150 to $399, depending on the car or home model chosen. A 2002 market research study conducted for XM

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concluded there would be a total of about 15 million satellite radio subscribers by the end of 2006. Considering that in spring 2005 both XM and Sirius raised their subscription rates to $12.95 monthly, the forecast turned out to be fairly close to the actual 13.6 million satellite radio subscribers in the United States reported at year-end 2006.

Both Sirius and XM employed a subscription-based business model to generate revenues. Subscribers received discounts if they had multiple XM or Sirius satellite radios (for different vehicles or for home and office use) or if they signed up for prepaid plans of two to three years. Both companies did not expect to cover the high startup costs and become profitable until acquiring at least 8 million to 10 million subscribers.

Competition between XM and Sirius Quickly Becomes Spirited and Expensive

Early on, the two companies became embroiled in a fierce market battle waged on multiple fronts:

- Creating a programming lineup that was more attractive than its rival's programming lineup.
- Convincing automakers to factory-install its brand of satellite radio (the radios of the two rivals were incompatible—XM radios could not receive signals broadcast by Sirius, and vice versa).
- Gaining broad retail distribution of its various satellite radio models and equipment for use at home or in used vehicles.
- Building brand awareness and stimulating consumer demand for satellite radio service.

The Race to Differentiate Programming Content While each company's programming strategy was to offer a diverse, appealing selection of digital-quality radio programs that would attract listeners willing to subscribe to mostly commercial-free programming, each company recognized that the key to gaining a competitive edge was having differentiated programming content capable of attracting and retaining the greatest number of subscribers. Each company quickly moved to create one or more channels for almost every music genre and a big assortment of channels devoted to news and commentary, sports, comedy and entertainment, family and health, religion, politics, traffic, and weather. By 2007, XM had a programming lineup of over 170 channels that included 69 commercial-free music channels; 5 commercial music channels; 37 news, talk, and commentary channels; 38 sports channels; and 21 instant traffic and weather channels. Sirius was broadcasting on 133 channels that included 69 channels of 100 percent commercial-free music and 64 channels providing sports programming, news, talk, information, entertainment, traffic, and weather. To achieve differentiation, both companies spent large, sometimes lavish, sums for contracts to:

- Obtain broadcast rights for the audio portions of programs on National Public Radio and such cable TV channels as Fox News, CNN, CNBC, MSNBC, ESPN News, and ESPN Radio.
- Gain *exclusive* rights to air live play-by-play broadcasts of various sporting events (Major League Baseball games, National Football League games, National Basketball Association games, National Hockey League games, college football and basketball games for all major conferences, professional golf and tennis tournaments, NASCAR races, horse races, FIFA World Cup soccer games, etc.). As an example of the large amounts spent to acquire exclusive rights for high-profile programming, XM paid $60 million annually for a six-year agreement to broadcast Major League Baseball games live nationwide for the years 2007 through 2012.
- Secure the services of well-known personalities and brands (like Howard Stern, Oprah Winfrey, and Martha Stewart Living) and create special channels featuring their shows and content. In 2004, Sirius signed a five-year contractual agreement with Howard Stern said to be worth $400 million to $500 million in salaries for Stern and his staff plus stock bonuses for Stern and his agent that were based on exceeding specified subscriber targets; Howard Stern broadcasts began on two Sirius channels in January 2006.

At XM, expenditures for programming and content were $101 million in 2005, $165.2 million in 2006, and $183.9 million in 2007. Sirius Satellite Radio's expenditures for programming were $100.8 million in 2005, $520.4 million in 2006, and $236.1 million in 2007. Apart from battling to achieve differentiated programming content, the two competitors also strived to attain overall product differentiation by offering greater geographic coverage, more commercial-free programming choices, and digital sound quality.

Partnering with Automakers and Gaining Broad Distribution in the Retail Marketplace Simultaneously, both XM and Sirius aggressively launched well-funded strategic initiatives to gain broad distribution of their satellite radios via partnerships with motor vehicle manufacturers, making satellite radios available at national and regional consumer electronics retailers and mass merchandisers (Best Buy, Walmart, and Target), and selling radios at their websites—all were sources of new subscribers. The battle was particularly fierce in the automobile segment for three reasons:

1. A big majority of the new subscribers for satellite radio service were the owners of newly purchased vehicles equipped with a satellite radio.
2. A majority of the satellite radios for new vehicles were factory-installed, although automobile dealers could install satellite radios in some models.
3. The incompatibility of XM and Sirius radios forced vehicle manufacturers to choose which brand to install in factory-assembled vehicles.

Each of the competitors lobbied hard for vehicle manufacturers to sign contractual agreements to exclusively install only its brand of satellite radio in vehicles scheduled to be equipped with a satellite radio. Both XM and Sirius used liberal subsidies and commissions to induce manufacturers to sign exclusivity agreements: Each rival paid automakers a subsidy if its brand of satellite radio and a prepaid trial subscription (usually for three months but sometimes for six months) was included in the sale or lease price of a new vehicle. As a further incentive, each paid automakers either a commission or a share of the subscription revenues to purchase, install, and activate its brand of satellite radio. There were also revenue-sharing payments on subsequent subscriptions by new vehicle owners after the trial period expired. For instance, XM had a long-term distribution agreement with General Motors whereby GM agreed to exclusively install only XM's brand of satellite radios in return for GM being paid a portion of the revenues derived from all subscribers using GM vehicles equipped to receive XM's service—this was in addition to the incentives XM paid to GM to subsidize a portion of the costs of installing XM radios in GM vehicles. Indeed, it was common practice for XM and Sirius to reimburse automakers for certain hardware-related costs, tooling expenses, and promotional and advertising expenses directly related to including a satellite radio as a vehicle option.

For the 2007 model year, Sirius radios were available as a factory-installed option in 89 vehicle models and as a dealer-installed option in 19 vehicle models; Sirius service was also offered to renters of Hertz vehicles at 55 airport locations nationwide. For the same model year, XM's satellite radios were available as original equipment in over 140 vehicle models.

In addition to offering subsidies and incentives to automakers, XM and Sirius also offered subsidies and incentives to (1) the manufacturers of their satellite radios, (2) the makers of chip sets and other components used in manufacturing satellite radios, (3) the various distributors and retailers of satellite radio devices and equipment, and (4) automotive dealers that installed satellite radios on vehicles not having a factory-installed satellite radio. Moreover, there were device royalties for certain types of satellite radios, subsidies for handling product warranty obligations, price protection for distributor inventories, and provisions for inventory allowances.

All of these expenses (except for revenue-sharing payments) were incurred in advance of acquiring a subscriber and were classified as subscriber acquisition costs. For XM, subscriber acquisition costs were $245.6 million in 2005, $224.9 million in 2006, and $259.1 million in 2007; Sirius incurred subscriber acquisition costs of $399.4 million in 2005, $451.6 million in 2006, and $407.6 million in 2007.

In 2006, the Federal Communications Commission, which had jurisdiction for satellite radio communications and had regulatory authority for issuing operating licenses for satellite radio enterprises, responded to growing numbers of consumer complaints about being locked into subscribing to the service of one company or the other, depending on the brand of satellite radio they had purchased. The FCC brought pressure on XM and Sirius to resolve the signal reception incompatibility and issued rules requiring the interoperability of both licensed satellite radio systems. Late in 2006, XM and Sirius signed an agreement to develop a unified standard for satellite radios to enable consumers to purchase one radio capable of receiving either company's broadcast signal and thus subscribe to whichever company's service they wished. The agreement called for the technology relating to this unified standard to be developed, jointly funded, and jointly owned by the two companies. Satellite radio manufacturers began including both XM and Sirius chip sets in their satellite radios to enable dual-signal reception in 2008; within months, all satellite radios were being manufactured with dual-reception capability.

Building Brand Awareness and Stimulating Demand for Satellite Radio Service Both XM and Sirius pursued aggressive marketing strategies, spending heavily on a variety of sizable sales, marketing, and promotional activities calculated to build brand awareness, communicate the appealing features of satellite radio service compared to traditional radio, and attract, first, hundreds of thousands and, then, millions of new subscribers annually. Advertising and promotional activities were conducted via television, radio, print, and the Internet; brochures illustrating the array of available channels and programs, along with other satellite radio features, were distributed at retail outlets, concert venues, and motor sports events and on the Internet to generate consumer interest; some major retailers participated in jointly funded local advertising campaigns. In-store promotions typically included displays at electronics and music stores, car audio retailers and other retailers that stocked and promoted sales of satellite radios, automobile dealerships, and rental car agencies with vehicles equipped with a satellite radio.

At XM, expenses for marketing and advertising were $182.4 million in 2005, $164.4 million in 2006, and $178.7 million in 2007. Sirius had sales and marketing expenses of $197.7 million in 2005, $203.7 million in 2006, and $173.6 million in 2007.

The Competitive Battle between XM and Sirius Inflicted Major Financial Damage

The heavy expenses incurred by the efforts of the two rivals as each tried to gain an edge over the other produced gigantic losses every year of their existence, despite having attracted millions of subscribers. Comparative performance statistics for 2005–2007 are shown in Exhibit 1.

With both companies burdened by sizable negative cash flows from operations, balance sheets that were becoming precariously weaker as long-term borrowings and stockholders' deficits mounted, waning ability to raise additional equity capital from increasingly anxious investors, and growing concerns about the viability of their business models, there was much speculation in 2006–2007 about whether either XM or Sirius could obtain the financing needed to survive for much longer. Executives at both companies concluded that after six years of battling for subscribers and bidding up programming costs, the only long-term solution was to merge and bring a halt to the destructive competitive battle that was unlikely to end short of bankruptcy. The executives and boards of directors of the two companies hammered out a planned merger agreement that was announced on February 19, 2007.

But there were significant hurdles to overcome because the merger, if approved by the FCC and the Antitrust Division of the U.S. Department of Justice, would create a satellite radio monopoly, although the merged company would still face competition for listeners from multiple sources, including terrestrial AM/FM radio, both free and paid Internet streaming services (from Clear Channel, CBS Radio, Pandora, and others), the music channels offered by cable TV providers, digital music devices such as iPods and MP3 players, and the music and other programming that could be stored on or streamed to smartphones. Traditional AM/FM radio enterprises offered free broadcast reception paid for by commercial advertising rather than by a subscription fee. Sirius and XM argued that the free broadcast programs of AM/FM enterprises (as well as all the other free and paid music programming that was widely available) not only reduced the likelihood that customers would be willing to pay for satellite radio subscription service but also imposed limits on what a merged XM-Sirius could charge for its service. Thus, it was alleged by XM and Sirius that competitive forces would be adequate to protect consumers from any "monopoly pricing" or other monopolistically abusive practices stemming from an XM-Sirius merger. However, many AM/FM enterprises, along with consumer interest groups and other interested parties, expressed opposition to the merger, largely on grounds that it would be anticompetitive and injurious to satellite radio subscribers.

After 17 months of regulatory scrutiny and despite the objections of various concerned parties, the proposed merger won approval from the FCC and the Antitrust Division of the U.S. Department of

EXHIBIT 1 Comparative Performance, XM Satellite Radio and Sirius Satellite Radio, 2005–2007 (dollar amounts in thousands, except per-subscriber data)

	2005	2006	2007
XM Radio			
Number of subscribers, year-end	5,933,000	7,629,000	9,027,000
Gross subscriber additions	4,130,000	3,866,000	3,891,000
Deactivated subscribers	1,427,000	2,170,000	2,493,000
Net subscriber additions	2,703,000	1,696,000	1,398,000
Subscriber revenues	$ 502,612	$ 825,626	$ 1,005,479
Total revenues	558,266	933,417	1,136,542
Operating expenses	1,113,801	1,336,515	1,647,979
Loss from operations	(555,535)	(403,098)	(511,437)
Net loss	(666,715)	(718,872)	(682,381)
Long-term debt	1,035,584	1,286,179	1,480,639
Total stockholders' (deficit) equity	80,948	(397,880	(984,303)
Cash flows from operations	$(166,717)	$(462,091)	$(154,730)
Average monthly revenue per subscriber	$10.57	$11.41	$11.48
Subscriber acquisition costs per gross subscriber addition*	$109	$108	$121
Sirius Satellite Radio			
Number of subscribers, year-end	3,316,560	6,024,555	8,321,785
Gross subscriber additions	2,519,301	3,758,163	4,183,901
Deactivated subscribers	345,999	1,050,168	1,886,671
Net subscriber additions	2,173,302	2,707,995	2,297,230
Subscriber revenues	$ 223,615	$ 575,404	$ 854,933
Total revenues	242,245	637,235	922,066
Operating expenses	1,071,385	1,704,959	1,435,156
Loss from operations	(829,140)	(1,067,724)	(513,090)
Net loss	(862,997)	(1,104,867)	(562,252)
Long-term debt	1,084,437	1,068,249	1,278,617
Total stockholders' (deficit) equity	324,968	(389,071)	(792,737)
Cash flows from operations	$(269,994)	$(421,702)	$(148,766)
Average monthly revenue per subscriber	$10.34	$11.01	$10.46
Subscriber acquisition costs per gross subscriber addition*	$139	$114	$101

*Subscriber acquisition costs include hardware subsidies paid to radio manufacturers, distributors, and automakers, including subsidies paid to automakers that included a satellite radio and subscription to Sirius or XM service in the sale or lease price of a new vehicle; subsidies paid for chip sets and certain other components used in manufacturing satellite radios; device royalties for certain radios and chip sets; commissions paid to automakers as incentives to purchase, install, and activate satellite radios; payments for handling product warranty obligations; freight; and provisions for inventory allowances associated with factory-installations of satellite radios by automakers and the orders and sales of satellite radio equipment by distributors and retailers.

Source: Company 10-K report for 2007.

Justice in July 2008 after XM and Sirius voluntarily agreed to:

1. Pay a $20 million fine for failure to previously comply with certain FCC regulations.
2. Sign a consent decree to cease such practices and bring their operating activities into full compliance with FCC regulations.
3. Not raise the retail price for, or reduce the number of channels in, the basic $12.95-per-month subscription package, or any new programming packages, before July 28, 2011.
4. Offer a variety of subscription plans (as opposed to a single all-channel option priced at $12.95 per month) that allowed subscribers to choose any of

several combinations of channels, including an à la carte subscription option.

The two companies quickly began preparations to finalize the merger. On August 5, 2008, Sirius Satellite Radio Inc. changed its name to Sirius XM Radio Inc. In April 2010, XM Satellite Radio Holdings Inc. merged with and into XM Satellite Radio Inc.; and in January 2011, XM Satellite Radio Inc., a wholly owned subsidiary of Sirius XM Radio, was merged into Sirius XM Radio Inc.

SIRIUS XM'S STRATEGY

In the period since the merger, Sirius XM's strategy had been aimed at:

- Recruiting new subscribers and rapidly growing the size of the company's customer base.
- Eliminating largely duplicative programming and thereby significantly reducing the combined programming costs of the two former companies.
- Cutting the "bloated" operating costs stemming from the mutually destructive and unprofitable "arms race" between XM and Sirius to outcompete one another.
- Streamlining operations in ways that would enable the merged company to become profitable within a few years.
- Reducing long-term debt, taking advantage of low interest rates to refinance existing debt, increasing the company's operating margins, boosting cash flows from operations, and getting the company on a strong financial footing.

Top executives believed it was essential to generate near-term results that would convince investors and creditors that the merged company's subscription-based business model was capable of producing attractive long-term profitability. This required progressively reducing the company's net losses per year and turning the corner to positive net profits in the 2011–2012 time frame.

Financial performance data for 2010–2013 is shown in Exhibit 2. Income from operations had climbed from $465.4 million in 2010 to $1.04 billion in 2013. From August 2012 to the end of 2013, Sirius refinanced $2.5 billion of debt, pushed the average maturities out from 4.7 years to 6.7 years, and reduced its weighted-average interest rates from 9.2 to 5.1 percent.

Assorted subscriber metrics are shown in Exhibit 3. Sirius XM Radio had a 38 percent equity interest in Sirius XM Canada, which offered satellite radio services in Canada and had 2 million subscribers in early 2014. However, subscribers to the Sirius XM Canada service were not included in Sirius XM's subscriber count.

Programming Strategy

Since the 2008 merger, the programming strategy had centered on three key elements:

1. *Bargaining hard for lower prices on programming content so as to reduce the company's overall programming costs.* Sirius XM executives were acutely aware that the fierce rivalry between XM and Sirius during 2002–2007 had led to significant "overbidding" for content. The overbidding resulted from trying to match or beat the content recently acquired by one's rival and/or sometimes agreeing to pay a big price premium to keep the other firm from winning exclusive rights to high-profile content with considerable listener appeal (like Howard Stern or play-by-play sporting events). Hence, as the contracts expired for programming content negotiated prior to the merger, the central objective during contract renegotiation was to reduce the premium prices the company was paying for high-profile broadcast rights, most particularly for sporting events and talk-show personalities (like Howard Stern).
2. *Curbing the costs of duplicate programming,* particularly in the case of music channels where both XM and Sirius were incurring the costs of programming "look-alike" channels, each operated as an individual station, in every music genre. For example, XM had four country-music channels, each with its own format, style, mix of recordings, and branding, that were programmed and hosted by a team of country-music experts, while Sirius also had four country-music channels, each with its own slightly different format, style, recordings mix, and branding, that were programmed and hosted by a different set of country-music experts. The same sort of duplication and overlap existed for the rock, pop, hip-hop, gospel, dance, jazz, Latin, and classical channels the two companies were broadcasting. Sirius XM executives promptly began a multiyear initiative

EXHIBIT 2 Select Financial Statement Data for Sirius XM Satellite Radio, 2010–2013 (in thousands, except per share data)

	2010	2011	2012	2013
Income statement data				
Revenue:				
Subscriber revenue[1]	$2,414,174	$ 2,55,414	$2,962,665	$3,824,660
Advertising revenue,[2] net of agency fees	64,517	73,672	82,320	89,288
Equipment revenue[3]	71,355	71,051	73,456	80,573
Other revenue[4]	266,946	274,387	283,599	344,574
Total revenue	2,816,992	3,014,524	3,402,040	3,799,095
Operating expenses:				
Royalty and revenue-sharing payments	435,410	471,149	551,012	677,642
Programming and content	305,914	281,234	278,997	290,323
Customer service and billing	241,680	259,719	294,980	320,755
Satellite and transmission	80,947	75,902	72,615	79,292
Cost of equipment	35,281	33,095	31,766	26,478
Subscriber acquisition costs	413,041	434,482	474,697	495,610
Sales and marketing	215,454	222,773	248,905	291,024
Engineering, design and development	45,390	53,435	48,843	57,969
General and administrative	240,970	238,738	261,905	262,135
Depreciation and amortization	273,691	267,880	266,295	253,314
Restructuring, impairments, and related costs	63,800	—	—	—
Total operating expenses	2,351,578	2,338,407	2,530,015	2,754,542
Income from operations	465,414	676,117	872,025	1,044,553
Other income (expense):				
Interest expense, net of amounts capitalized	(295,643)	(304,938)	(265,321)	(204,671)
Loss on extinguishment of debt and credit facilities, net	(120,120)	(7,206)	(132,726)	(190,577)
Interest and investment income (loss)	(5,375)	73,970	716	6,976
Loss on change in value of derivatives	—	—	—	(20,393)
Other (loss) income	3,399	3,252	(226)	1,204
Total other expense	(417,739)	(234,922)	(397,557)	(407,461)
Income before income taxes	47,675	441,195	474,468	636,092
Income tax benefit (expense)	(4,620)	(14,234)	2,998,234	(259,877)
Net income	$ 43,055	$ 426,961	$3,472,702	$ 377,215
Net income per common share:				
Basic	$0.01	$0.07	$0.55	$0.06
Diluted	$0.01	$0.07	$0.51	$0.06
Dividends paid on common stock	—	—	$0.05	—
Weighted-average common shares outstanding:				
Basic	3,693,259	3,744,606	4,209,073	6,277,646
Diluted	6,391,071	6,500,822	6,873,786	6,384,791
Balance sheet data				
Cash and cash equivalents:	$ 586,691	$ 773,990	$ 520,945	$ 134,805
Total current assets	991,775	1,276,954	1,828,182	1,419,013
Total assets	7,383,086	7,495,996	9,054,843	8,844,760
Total current liabilities	2,349,709	2,247,596	2,314,588	2,948,904
Long-term debt, including related-party debt	3,021,763	3,012,351	2,430,986	3,093,821
Total stockholders' equity	$ 207,636	$ 704,145	$ 4,039,565	$ 2,745,742

	2010	2011	2012	2013
Cash flow data				
Net cash provided by operating activities	$ 512,895	$ 543,630	$ 806,765	$ 1,102,832
Repayment of long-term borrowings	1,262,396	234,976	1,041,824	1,982,160
Proceeds from long-term borrowings and revolving credit facility, net of costs	1,274,707	—	383,641	3,156,063

[1]Includes revenues from all the various subscription plans, activation fees (including those for radios activated on vehicles rented at participating car rental agencies), and other fees.
[2]Includes the sale of advertising on certain nonmusic channels, net of agency fees. Agency fees are based on a contractual percentage of the gross advertising revenue.
[3]Includes revenue and royalties associated with the sale of satellite radios, components, and accessories.
[4]Includes amounts charged to subscribers for the U.S. music royalty fee (this fee was a surcharge on all subscription plans involving music channels), royalties earned from the operations of the company's Canadian affiliate, and ancillary fees earned on weather, traffic, data and Backseat TV services.

Source: Company 10-K reports, 2011, 2012, and 2013.

to consolidate the roughly 70 music channels broadcast by XM and the 70 or so music channels broadcast by Sirius into a new set of about 70 music channels that were jointly broadcast to XM subscribers and to Sirius subscribers.

3. *Refreshing and expanding the company's programming lineup.* Sirius executives viewed programming as the foundation of the company's business. To complement and strengthen Sirius XM's broad channel lineup and offering of exclusive programs,

EXHIBIT 3 Select Subscriber Statistics, Sirius XM Satellite Radio, 2010–2013

	2010	2011	2012	2013
Subscriber data				
Beginning subscribers	18,772,758	20,190,964	21,892,824	23,900,336
Gross subscriber additions	7,768,827	8,696,020	9,617,771	10,136,391
Deactivated subscribers	(6,350,621)	(6,994,160)	(7,610,259)	(8,477,407)
Net additions	1,418,206	1,701,860	2,007,512	1,658,974
Self-pay	982,867	1,221,943	1,661,532	1,511,543
Paid promotional (trial)	435,339	479,917	345,980	147,431
Ending subscribers	20,190,964	21,892,824	23,900,336	25,559,310
Self-pay	16,686,799	17,908,742	19,570,274	21,081,817
Paid promotional (trial)	3,504,165	3,984,082	4,330,062	4,477,493
Subscriber metrics				
Daily weighted-average number of subscribers	19,385,055	20,903,908	22,794,170	24,886,300
Average self-pay monthly churn*	1.9%	1.9%	1.9%	1.8%
New-vehicle conversion rate from trial to self-pay	46%	45%	45%	44%
Average revenue per subscriber	$11.53	$11.73	$12.00	$12.27
Subscriber acquisition cost, per gross subscriber addition	$59	$55	$54	$50
Customer service and billing expense per average subscriber	$1.03	$1.03	$1.07	$1.07

*Derived from the average of the quarterly average self-pay monthly churn during the year. The average self-pay monthly churn for a quarter is calculated by dividing the monthly average of self-pay deactivations for a quarter by the average self-pay subscriber balance for a quarter.

Sources: Company 10-K report, 2012, pp. 30 and 32; and company 10-K report, 2013, pp. 31 and 33.

management continuously looked for new and unique brands and personalities to collaborate with and develop content that was unavailable to terrestrial radio and online competitors. The strategic objective was to continue to build record numbers of subscribers by producing innovative and appealing content.

Company efforts to cut programming costs had been successful. When interviewed by a *Barron's* reporter in fall 2013, Sirius XM CEO Jim Meyer was quoted as saying:[1]

> Before we merged, our programming cost was $450 million for everything besides music. Now, it's under $300 million. And that's not going to change a lot.

One industry analyst estimated that Sirius XM's monthly programming costs were $0.96 per subscriber in 2013 and would likely fall to $0.76 per subscriber by 2016 because of flat programming costs and growing numbers of subscribers.[2]

Music Programming Sirius XM's music offerings were regularly adjusted and fine-tuned to remain in step with the ongoing changes in the tastes and preferences of music listeners and the shifting popularity of music artists. The channels created by the company were broadcast commercial-free, but certain music channels were programmed by third parties and aired commercials. The 2013 channel lineup also featured interviews and performances of some of the biggest names in music, a *Town Hall* series that featured concerts and interviews before a live audience, and several "pop-up" channels featuring the music of particular artists.

In 2013, music programming accounted for about 60 percent of the company's total programming costs.[3] Sirius XM had to pay royalties to the music publishers, recording studios and record companies, songwriters, and performing artists whose musical works were broadcast on its channels. In some cases, the royalty rate was negotiated directly with the copyright owners or their representatives; but if no agreements were reached, the laws in the United States governing copyrights called for the royalty rates to be determined by the Copyright Royalty Board (CRB) of the Library of Congress. In December 2012, the CRB determined that the royalties paid on sound recordings broadcast over satellite radio for the five-year period starting January 1, 2013, and ending December 31, 2017, would be based on subscription revenue from U.S. satellite digital audio radio subscribers and advertising revenue from channels other than those channels that make only incidental performances of sound recordings and that the royalty rates would be 9 percent for 2013, 9.5 percent for 2014, 10 percent for 2015, 10.5 percent for 2016, and 11 percent for 2017. The rate for 2012 was 8 percent. However, revenues derived from the following were not subject to CRB-mandated royalty payments: (1) channels, programming, and products or other services offered for a separate charge when such channels make only incidental performances of sound recordings, (2) equipment sales, (3) current and future data services, and (4) certain other services and activities. In addition, the regulations allowed Sirius XM to reduce its monthly royalty fee in proportion to the percentage of its music performances that featured pre-1972 recordings (which were not subject to federal copyright protection) as well as those that were licensed directly from the copyright holder, rather than through a statutory license. Sirius XM charged all U.S. subscribers a U.S. music royalty fee, as an add-on to the regular subscription price, to cover the music royalty payments required by the CRB.

Sports Programming Live play-by-play sports were an important part of Sirius XM's programming strategy. In 2013–2014, Sirius XM was the Official Satellite Radio Partner of the National Football League (NFL), the National Hockey League (NHL), and the PGA TOUR, and it broadcast most major college sports, including NCAA Division I regular-season football and basketball games, over 30 college football bowl games, and all tournament games of the NCAA Division 1 Men's Basketball Championship. There were broadcasts of soccer matches from the Barclays Premier League, FIS Alpine Skiing events, FIFA World Cup events, and horse racing. In addition, the sports lineup included a number of exclusive talk channels and programs such as MLB Network Radio, SiriusXM NASCAR Radio, Sirius XM NFL Radio, College Sports Nation, and Chris "Mad Dog" Russo's *Mad Dog Unleashed* on Mad Dog Radio, as well as two ESPN channels (ESPN Radio and ESPN Xtra). Simulcasts of select ESPN television shows, including *SportsCenter,* were broadcast on the company's ESPN Xtra channel.

Sirius XM's contract to broadcast every Major League Baseball game ran through 2021. Its agreement with the National Football League was up for renewal at the end of 2015.

Talk and Entertainment Programming Sirius XM's channel lineup included about 30 talk and entertainment channels that were designed for a broad variety of audiences and thus differentiated the company's programming from terrestrial radio and other audio entertainment providers. The talk-radio listening options featured a multitude of popular talk personalities, some with their own radio shows that aired exclusively on Sirius XM, including Howard Stern, Oprah Winfrey, Dr. Laura Schles singer, Opie and Anthony, Bob Edwards, former senator Bill Bradley, and doctors from the NYU Langone Medical Center. Subscribers could listen to a range of humor on Sirius XM's comedy channels, including Jamie Foxx's The Foxxhole, Laugh USA, Blue Collar Comedy, and Raw Dog Comedy. Other talk and entertainment channels included a full-time channel devoted to business and management, SiriusXM Book Radio, Kids Place Live, Radio Disney, Rural Radio, Cosmo Radio, OutQ, Road Dog Trucking, and Playboy Radio. Religious programming included The Catholic Channel (programmed with the archdiocese of New York), EWTN (Catholic programming and news programming from around the world), and Family Talk.

The company's contract with Howard Stern was up for renewal at the end of 2015. According to media reports, the five-year contract Sirius XM and Howard Stern signed in December 2010 called for Sirius XM to pay an estimated $80 million annually for Howard Stern programming, down 20 percent from the approximately $100 million annual payments (including bonuses) for the initial five-year contract signed in 2004. Some observers had speculated that Stern's declining popularity and listener base might give Sirius XM greater leverage in negotiating to renew its contract with Stern in 2015. Sirius had already made some progress in reducing the prices of its highest-paid radio personalities—both Martha Stewart and Bubba the Love Sponge Clem had already agreed to reduced compensation.

News and Information Programming There was a wide range of national, international, and financial news, including news from CNBC, CNN, Fox News, HLN, Bloomberg Radio, MSNBC, NPR, BBC World Service News, and World Radio Network, plus several political call-in talk shows on a variety of channels and Sirius XM's exclusive channel, POTUS. Subscribers could get local traffic reports for 22 metropolitan markets throughout the United States.

Internet Radio Sirius XM streamed music channels and select nonmusic channels over the Internet, including several channels and features that were not available to satellite radio subscribers. Access to the company's Internet services was offered to satellite radio subscribers for an additional fee. Sirius XM marketed devices that enabled access to its Internet services without the need for a personal computer. It had also developed apps that allowed consumers to access the company's Internet services on certain smartphones and tablet computers.

In 2012, the company launched SiriusXM On Demand that gave Internet subscribers listening on the company's online media player and on smartphones the ability to choose their favorite episodes from a library of more than 300 shows and over 3,000 hours of content that included regularly updated feature content, commercial-free music from many genres, *Town Hall* specials, music specials, interviews with a wide range of celebrities, *The Howard Stern Show,* Dr. Laura, Jimmy Buffett concerts, Coach K, *Bob Dylan's Theme Time Radio Hour,* and selected shows from the company's lineup of sports, comedy, and exclusive talk and entertainment channels.

More recently, Sirius had introduced MySXM that permitted listeners to personalize the company's existing commercial-free music and comedy channels to create a more tailored listening experience. Channel-specific sliders allowed users to create over 100 variations of each of more than 50 channels by adjusting characteristics like library depth, familiarity, music style, tempo, region, and multiple other channel-specific attributes. SiriusXM On Demand and MySXM were offered to Internet subscribers at no extra charge.

In 2013 Sirius expanded its online offering to further enhance the appeal of subscribing to Sirius XM Internet Radio. Top management believed that coordinating the content and programming attractions across its satellite and streaming platforms would allow the company to provide subscribers with an "unparalleled experience."[4]

Dynamic Programming Content and Channel Content Sirius XM monitored the popularity of the content on each channel and the size of the audience listening to each channel. Channels with uneconomically low listener appeal either were dropped or had their content revised. Programming of existing channels was periodically refreshed. From time to time, new channels with altogether new content were added to the lineup of channel offerings. In 2012, the company launched a Comedy Central Radio channel and added Michael Smerconish, a nationally syndicated terrestrial talk-radio star, to its lineup in its ongoing campaign to bring the best audio entertainment to subscribers. In 2013, prominent programming additions included numerous *Town Hall* special events with high-profile personalities, dozens of new weekly programs and special events on existing channels, and the launch of a David Bowie channel, an expanded Pink Floyd channel, a Just for Laughs comedy channel, a Tom Petty Radio channel, an Entertainment Weekly channel (in partnership with *Entertainment Weekly*, which was the content provider), a The Girls' Room channel, and a Bon Jovi channel.

Several times each month, the company sent e-mails to subscribers calling attention to upcoming programs, shows, and events of interest scheduled for broadcast across its entire channel lineup. The e-mails also announced the launch of new shows on particular channels, temporary switches to seasonal music on particular channels, and any other noteworthy items (contests to win tickets to live performances and major sporting events, the appearance of special guests and/or the discussion of particular topics on regularly scheduled talk and entertainment shows, and the availability of certain videos that could be watched on the company's website or streamed to subscribers' tablets or smartphones). The e-mails served to heighten subscriber interest in satellite radio and build awareness of the dynamic and unique nature of Sirius XM's programming and how its diverse channel lineup and content offered "something for everyone and every mood."

Programming Studios Sirius XM's programming activities were conducted principally in studio facilities occupying a full floor at the company's corporate headquarters building in midtown Manhattan and at studios in Washington, D.C. The company also operated smaller studio facilities in Cleveland, Los Angeles, Memphis, Nashville, and Austin. Both the New York City and Washington, D.C., offices housed facilities for programming origination, programming personnel, and programming transmission to the company's 140-plus channels.

Radio Distribution Strategy

Following the merger in 2008, Sirius XM continued to employ the strategy of gaining access to new subscribers by distributing its satellite radios through three channels: automakers, assorted retail locations nationwide (including rental car companies), and the company's website. As had been the case during 2002—2008, when XM and Sirius battled each other for new subscribers, the merged Sirius XM continued to use subsidies and incentives to induce automakers to install a satellite radio and to partner with Sirius XM in promoting satellite radio service to customers who bought or leased a new vehicle equipped with a satellite radio.

Automakers Just as had been the case prior to the merger, Sirius XM's primary means of distributing satellite radios (and gaining new subscribers) was through the sale and lease of new vehicles equipped with satellite radios. The purchasers of new or leased motor vehicles had, from the onset of satellite radio service, been the chief source of new subscribers. Listening to satellite radio broadcasts while driving had gained in popularity in the years since broadcasts began in 2002, spurring vehicle manufacturers to equip an increasing fraction of new vehicles, particularly models selling for $30,000 or more, with factory-installed satellite radios. About 70 percent of the 15.6 million new vehicles sold in the United States in 2013 had satellite radios (up from 33 percent in 2007), and the percentage was to grow in coming years. New vehicle sales were forecast to be around 16.3 million in 2014. Sirius XM's subscriber growth since 2009 had been driven largely by the recovery in automotive sales that had been under way since the Great Recession of 2008—2009, when annual sales in the United States in 2009 fell to 10.4 million vehicles.

To help boost the percentage of vehicles equipped with satellite radios, Sirius XM had continued the practice of using subsidies and incentives to induce automakers to offer satellite radios as a factory- or dealer-installed option in substantially all vehicle makes sold in the United States. Since the merger, Sirius XM had been successful in signing agreements with almost all vehicle makers whereby Sirius XM paid certain specified subsidies and incentives for each satellite radio installed in a new or leased vehicle. Sirius executives believed that these subsidies and incentives, coupled with growing driver enthusiasm for satellite radio service, would continue to broaden the distribution of satellite radios and boost the company's ability to attract growing numbers of new subscribers.

The Retail Channel Sirius distributed and marketed its satellite and Internet radios through major national and regional retailers; to secure broader distribution, the company relied heavily on subsidies and incentives to induce retailers to stock satellite radios and promote Sirius XM's satellite radio service. Sirius also provided these retailers with an assortment of in-store merchandising materials to support their efforts to sell satellite radios to consumers, and it provided sales force training for several retailers.

In addition, the company's distribution strategy in the retail channel included:

- Using subsidies and incentives to induce distributors to stock satellite radio equipment and fill the orders of retailers who sold satellite radios.
- Selling satellite and Internet radios directly to consumers at the company's website.
- Working with certain rental car companies to equip a portion of the vehicles in their rental car fleets with satellite radios and to offer satellite radio service to their car rental customers.

Sales and Marketing Strategy

Because Sirius XM's primary source of revenue was subscription fees, the company's sales and marketing strategy was concentrated on programs and initiatives to attract and retain new subscribers and rapidly grow its subscriber base. Going into 2014, Sirius XM radios were installed in close to 60 million vehicles in the United States, a number that represented 30 percent of the 200 million nonfleet registered vehicles on the road. With new vehicle sales in the United States running at 15 million to 16 million vehicles annually, roughly 11 million new vehicles per year were being equipped with a satellite radio. Approximately 110 million satellite-equipped vehicles were expected to be on the road in 2019.

Sirius CEO Jim Meyer expected the company to easily get to 30 million subscribers and believed that reaching 40 million subscribers was feasible in the not too distant future.[5] To achieve those numbers, Sirius was concentrating its sales and marketing efforts to gain new subscribers in both the new vehicle and used-vehicle segments, using subsidies and incentives to automakers, the retailers of used vehicles, and the retailers of satellite radios, complemented with telemarketing efforts to nonsubscribing owners of vehicles equipped with satellite radios.

However, the company had over $500 million in annual revenues from other sources, including the sale of advertising on select nonmusic channels, equipment revenues and royalties associated with the sale of satellite radios and accessories, amounts earned from subscribers through the U.S. music royalty fee, royalties from the company's Canadian affiliate, and ancillary fees from weather, traffic, data, and Backseat TV services—see Exhibit 2. Consequently, a portion of the company's sales and marketing strategy was aimed at growing these revenue streams.

Subsidies and Incentives for Automakers Far and away the biggest marketing effort to secure new subscribers continued to be directed at people who purchased or leased new vehicles. This effort began with the long-standing practice of rewarding automakers for installing a satellite radio in new vehicles and including a three-month or six-month trial subscription to Sirius satellite service in the sale or lease price of these vehicles. The incentive package Sirius offered had induced every major automaker to offer satellite radios as a factory or dealer-installed option in substantially all makes of vehicles sold in the United States.

As a general rule, Sirius received trial subscription payments from automakers in advance of activating the trial subscription on the day the vehicle was purchased or leased from franchised dealers. Furthermore, Sirius reimbursed various automakers for certain costs associated with the satellite radios installed in their vehicles, including hardware costs, tooling expenses associated with installing satellite radios, and promotional and advertising expenses. And it shared with certain automakers a portion of the revenues it got from subscribers driving their satellite radio–equipped models. All of these subsidies, incentives, and expenses for cooperative marketing programs were classified as subscriber acquisition costs. To complement this effort, Sirius had been using outbound telemarketing campaigns to contact the nonsubscribing owners of new vehicles and try to convert them into becoming subscribers.

Trial Subscriptions with Purchase or Lease of Used Vehicles Equipped with a Satellite Radio In recent years, Sirius XM had accelerated its sales and marketing efforts to help induce people who bought or leased previously owned vehicles with factory-installed or dealer-installed satellite radios to subscribe to Sirius XM service. The company had recently developed systems and methods to identify these people and had established marketing programs to promote its programming to these potential subscribers. The company worked directly with franchised and independent vehicle dealers to promote and sell Sirius XM subscriptions for both certified and noncertified used vehicles equipped with satellite radios. It had launched subscriber programs at large used-car retailers, such as CarMax, AutoNation, and Penske, and over 11,000 other dealer locations to enhance its capabilities to gain new subscribers when satellite radio–enabled vehicles changed ownership. The centerpiece of Sirius XM's program with these participating used-vehicle retailers was giving a three-month Sirius XM trial subscription to customers buying any preowned vehicle with a factory-equipped satellite radio; in addition, the dealers reported the sale of such vehicles to Sirius. About 34 percent of used-car owners converted their three-month trial subscriptions to self-paying subscriptions.

In 2013, Sirius XM began enrolling dealers in its Service Lane Program to provide a complimentary two-month Sirius XM subscription to qualifying customers who brought their vehicles with a factory-equipped satellite radio in for service; there were over 2,500 dealers participating in the Service Lane Program as of February 2014. Both the used-car dealer and Service Lane programs also involved providing subsidies and/or revenue-sharing incentives of one kind or another, as well as providing promotional materials and participating in various cooperative marketing activities. The company was also using telemarketing to promote Sirius XM to nonsubscribing owners of satellite radio–equipped used vehicles.

The strategic target was to convert some of the 30 million vehicles on the road with inactive satellite radios into vehicles with active subscriptions to Sirius XM's service. At the end of the 2013 third quarter, Sirius was on track to gain 1.5 million in gross subscriber additions in the used-vehicle segment in 2013 (up from 1 million in 2012); the used-vehicle conversion rate from trial subscriptions to paid subscriptions was running above 30 percent.

Subsidies and Incentives for the Retailers of Satellite Radios Subsidies and incentives were also used to induce retailers to stock satellite radios and promote Sirius XM's satellite radio service. They included hardware subsidies paid to retail distributors, inventory allowances, in-store merchandising materials, sales force training for large-volume retailers, the handling of product warranty obligations on radios sold, loyalty payments, commissions (or some other sort of revenue-sharing arrangement) on subsequent subscriptions, and payments to reimburse retailers for the cost of advertising and other product awareness activities performed on Sirius XM's behalf.

Share-based payments of subscription revenues to automakers, franchised dealers, independent used-car dealers, and the retailers of satellite radios totaled $68.9 million in 2013, $63.8 million in 2012, $53.4 million in 2011, and $63.3 million in 2010. These payments appeared on the company's income statement in the operating expense category labeled "Royalty and revenue-sharing payments"—see Exhibit 2.

A Variety of Subscription Plans and Subscription Packages Sirius marketers had created a variety of subscription plans for customers to choose from—Exhibit 4 shows the three most popular plans. Most customers, especially newer subscribers, opted for annual, semiannual, quarterly, or sometimes monthly subscription plans. To entice customers whose subscriptions were expiring to sign up for a longer term, Sirius offered discounts for prepaid subscriptions and for automatic-renewal plans that ran for terms of two or three years. There were also discounts for customers who subscribed for service for two or more vehicles or had multiple radios for home and/or office use—roughly 80 percent of car-owning households in the United States owned two or more vehicles. The percentages of subscribers taking advantage of the discounts for longer-term plans and multiple-vehicle service were rising. From time to time, Sirius ran special promotions offering slightly deeper discounts on these plans.

Subscribers having an à la carte–capable radio (Sirius Starmate 8) could customize the programming they received; there were two à la carte

EXHIBIT 4 Sirius XM's Most Popular Subscription Plans, February 2014

	Sirius or XM Select	Sirius or XM All Access	Sirius or XM Mostly Music
Monthly subscription	$14.99	$18.99	$9.99
Quarterly subscription	$44.97 ($14.99 per month)	$56.97 ($18.99 per month)	$27.97 ($9.99 per month)
Annual subscription	$164.89 ($13.74 per month) 1 free month	$199.00 ($16.58 per month) 1 free month	$119.88 ($9.99 per month)
2-year subscription	$314.79 ($13.12 per month) 3 free months	$398.00 ($16.58 per month) 3 free months	$239.76 ($9.99 per month)
3-year subscription	$464.69 ($12.91 per month) 5 free months	$588.69 ($16.35 per month) 5 free months	$359.64 ($9.99 per month)
Addition of a second radio	$9.99 per month	$13.99 per month	$9.99 per month
Number of channels	Over 140 channels	Over 150 channels plus online listening	Over 80 channels
Internet Radio	Add $4 per month	Included	Add $4 per month
Howard Stern	√	√	x
Oprah Radio, Opie and Anthony, Bob Edwards	x	√	x
Every NFL game	√	√	x
Every NASCAR race	√	√	x
Every MLB game	x	√	x
NBA and NHL games and PGA Tour coverage	x	√	x
Up-to-the-minute traffic and weather coverage for 22 locations	√	√	x

Source: Company website (accessed February 4, 2014).

subscription plans—one allowed subscribers to pick their 50 favorite channels within the Select package for a monthly price of $7.99, and the other allowed subscribers to choose 100 channels (not including live sports broadcast channels) for a monthly price of $15.99. There were also two family-friendly packages that did not contain adult-themed channels and had $1-per-month cheaper subscription prices, a 50+ channel news-sports-talk package priced at $9.99 per month, and a 155-channel Internet-only plan (for people who preferred to listen on a computer, tablet, smartphone, or other Internet-enabled device) priced at $14.99 per month—people who signed up for the Internet-only plan got a 30-day free trial. Because a substantial number of subscribers were driving older motor vehicles equipped with XM or Sirius radios that did not permit dual-signal reception, the company still had to broadcast both XM signals and Sirius signals rather than just a single signal. But the subscription plan packages and prices for customers with either XM or Sirius radios were identical.

Sales and Marketing Expenses Sirius XM's costs for sales and marketing activities are shown in Exhibit 2. These expenses included (1) expenditures for advertising, promotional events, and sponsorships, (2) reimbursement payments to automakers and retailers for advertising costs, certain cooperative marketing activities, and other product awareness activities performed on Sirius XM's behalf, (3) expenses related to direct mail, outbound telemarketing, and e-mail, and (4) personnel costs. Management anticipated that future sales and marketing expenses would increase as the company launched seasonal advertising, expanded promotional initiatives to attract new subscribers, and boosted efforts to retain existing subscribers and win back former subscribers.

Customer Service and Customer Care Strategy

One of Sirius XM's top strategic priorities was to help boost subscriber retention rates through improvements in customer service and overall customer satisfaction. To improve customer retention and customer satisfaction metrics by making it easier and more satisfying to be a Sirius XM subscriber, the company had:

- Made significant investments in customer care and assembled a team of experienced customer service personnel to perform an assortment of customer support activities.
- Increased its capabilities to "chat" with online customers—a function that online customers liked and used when trying to manage their accounts, purchase equipment, and resolve other questions or issues they had.
- Expanded the customer self-service options that enabled subscribers to perform more transactions online.
- Integrated its subscriber management systems to enable Sirius radios and XM radios to exist on a single consolidated account.
- Launched a mobile service app to allow transactions and account management from a subscriber's smartphone.

Satellite Systems and Operations Strategies

In 2014 Sirius had a fleet of 10 orbiting satellites, costing an average of $300 million each; four were manufactured by Boeing Satellite Systems and six were manufactured by Space Systems/Loral. The company used launch and in-orbit insurance to mitigate the potential financial impact of satellite launch and in-orbit failures unless the premium costs were considered to be uneconomical relative to the risk of satellite failure. The satellite fleet provided clear reception in most areas despite terrain variations, buildings, and other obstructions. Subscribers could receive transmissions at all outdoor locations in the continental United States where the satellite radio had an unobstructed line of sight with one of the satellites or was within range of one of the company's 700 terrestrial repeaters to supplement satellite coverage.

Sirius controlled and communicated with the satellites from facilities in North America and also maintained earth stations in Panama and Ecuador to control and communicate with several satellites. The satellites were monitored, tracked, and controlled by a third-party satellite operator.

Satellite Radios Sirius did not manufacture satellite radios. Rather, it designed the radios, established their specifications, either sourced or specified the needed parts and components, and managed various aspects of the logistics and production of its satellite and Internet radios. It had authorized manufacturers and distributors to produce and distribute radios, and it had licensed the company's technology to various electronics manufacturers to develop, manufacture, and distribute radios under brands other than Sirius XM. It also was responsible for obtaining FCC certification of its radios. Sirius purchased radios from these manufacturers for distribution through the company's website. To facilitate the sale of its radios, Sirius typically subsidized a portion of the radio manufacturing costs to reduce the hardware price to consumers—the majority of these subsidies were paid to the makers of the chip sets (microprocessors) used in its radios and to the suppliers of certain other parts and components.

Radios were manufactured in four principal configurations—in-dash radios for new and used motor vehicles, Dock & Play radios, home or commercial units, and portable radios. In 2011, Sirius introduced the Sirius XM Edge, a Dock & Play radio featuring a technology that expanded the company's available channel lineup and data bandwidth. At the time, the Edge was the only Sirius XM radio able to access Sirius XM's new 2.0 technology; it was sold at retail locations and on the Sirius XM website for $139.99. Later, Sirius XM introduced the Lynx model, a portable radio with Sirius XM 2.0 satellite and Internet radio capability. In addition, there was an interoperable radio, MiRGE, which had a unified control interface allowing for easy switching between the XM and Sirius satellite radio networks. Sirius's other important radio model was the XM SkyDock, which connected to an Apple iPhone and iPod touch and provided live XM satellite radio using the control capability of the iPhone or iPod touch. A new model, the Sirius XM Onyx Plus Dock & Play radio, priced at $99.99, was introduced in November 2013. The Onyx Plus had the capability to receive all of the channels of the company's previous satellite radios plus Sirius XM's expanded channel lineup and SiriusXM Latino, a suite of Spanish-language channels, and was packed with advanced features. With Onyx Plus, the listener was able to:

- Store up to 20 channels for one-touch access, including 18 Smart Favorite channels.
- Automatically start songs from the beginning when tuned to a Smart Favorite music channel with TuneStart.
- Create a customized music channel that was a blend of the Smart Favorite music channels with TuneMix.
- Scan and select songs that had already played on the Smart Favorite music channels with TuneScan.
- Pause, rewind, and replay live satellite radio plus go back and replay music, news, talk, or sports segments on all Smart Favorite channels.
- Browse what was playing on other channels while listening to the current one.
- Get alerts so that the listener wouldn't miss any favorite artists, songs, and games.
- Get score alerts when scores occurred in games that involved the user's favorite teams.
- Catch up on the latest sports scores with Sports Ticker.
- Jump back to the previous channel with One-Touch Jump.
- Lock and unlock channels with mature content.

Onyx Plus also boasted a large color graphic display for viewing album art and channel logos, program and channel information, and song and show titles.

New Technology and Expanded Online and Two-Way Wireless Capabilities In 2013, Sirius introduced the SiriusXM Internet Radio app for smartphones and other connected devices to make Sirius XM programming more widely available. In 2013–2014, Sirius accelerated efforts to develop and deliver in-vehicle technology and systems with greater capabilities and connectivity. It was participating in an initiative with Nissan to provide a comprehensive suite of services that would allow for crash notification, stolen or parked vehicle locator service, remote vehicle diagnostics, roadside assistance, monitoring of vehicle emissions, and other safety and convenience measures. In November 2013, Sirius completed the acquisition of the connected-vehicle services business of Agero, Inc., giving it significantly greater capability to develop a connected-vehicle platform and begin delivering connected-vehicle services to a host of major automotive manufacturers. Agreements had already been negotiated with Acura, BMW, Honda, Hyundai, Infiniti, Lexus, Nissan, and Toyota, with several others in the pipeline, making Sirius the current leader in providing connected-vehicle services to automakers. Sirius XM's offerings included safety, security, and convenience services for drivers and end-to-end, turnkey solutions for automakers. The company expected to earn revenues of $100 million from providing these services in 2014 and expected these revenues to reach $200 million in the next three years.

COMPETITION

Despite being the monopoly provider of satellite radio service in the United States, Sirius XM nonetheless faced significant competition for both listeners and advertisers from a number of diverse sources—in addition to prerecorded, disc-based music entertainment that consumers could purchase and play in cars and homes and on various portable devices.

Broadcasters of Analog and Digital AM/FM Radio Programs

The broadcasters of AM/FM programs had a loyal listener base numbering in the tens of millions and long-standing demand for their product offerings They utilized an advertising-based business model that provided free broadcast reception paid for by commercial advertising. Stations chose one of several basic programming formats (music, talk, sports, religious, news, educational, ethnic), put their own differentiating spin on the selected programming format, and then tried to make money by selling a sufficient number of advertising spots at rates commensurate with their audience ratings to produce a profitable revenue stream. Radio stations competed for listeners and advertising revenues with other radio stations in their geographic listening area based on such factors as program content, on-air talent, transmitter power, and audience demographics; these factors, along with audience size and the number and characteristics of other radio stations in the area, affected the rates they were able to charge for advertising. Some AM/FM radio stations had reduced the number of commercials per hour, expanded the range of music played on the air, and experimented with new formats in order to lure customers away from satellite radio.

In recent years, most AM/FM radio stations had begun broadcasting digital signals as well as the older analog signals. Digital signals had clarity similar to Sirius XM signals but made a difference only to listeners with a digital or HD radio. Many AM/FM broadcasters were also complementing their HD radio efforts by aggressively pursuing Internet radio, wireless Internet-based distribution arrangements, and data services. Several automakers had installed HD radio equipment as factory standard equipment in select models, and more were planning to shift from installing analog radios as standard equipment to installing digital radios.

Internet Radio Broadcasters and Internet-Enabled Smartphones

Internet radio broadcasts typically had no geographic limitations and provided listeners with radio programming from across the country and around the world. Major media companies and online-only providers, including Clear Channel, CBS and Pandora, made high-fidelity digital streams available through the Internet for free or, in some cases, for a fraction of the cost of a satellite radio subscription. Pandora, for example, had 70 million listeners and 3 million paying subscribers. Online broadcasters competed directly with Sirius XM's services in automobiles, at home, on mobile devices, and wherever audio entertainment was consumed. Internet-enabled smartphones, most of which had the capability of interfacing with vehicles, could play recorded or cached content and access Internet radio via dedicated applications or browsers. These applications were often free to the user and offered music and talk content as long as the user had subscribed to a sufficiently large mobile data plan. Leading audio smartphone radio applications included Pandora, last.fm, Slacker, iheartradio, and Stitcher. Certain of these applications also included advanced functionality, such as personalization, and allowed the user to access large libraries of content and podcasts on demand.

Spotify had launched a music-streaming service in the United States that allowed its users unlimited, on-demand access to a large library of song tracks, enabling the sharing of playlists with other listeners through the Facebook platform. Other similar services had launched Facebook integration, including MOG and Rdio. These services, which usually required a monthly subscription fee, were currently available on smartphones but were likely to become integrated into connected vehicles in the future.

Third-generation (G3) and fourth-generation (G4) mobile networks had enabled a steady increase in the audio quality and reliability of mobile Internet radio streaming, and this was expected to further increase as G4 networks became standard. Sirius executives expected that improvements from higher bandwidths, wider programming selection, and advancements in functionality would continue making Internet radio and smartphone applications an increasingly significant competitor, particularly in vehicles.

Because the audio entertainment marketplace was evolving rapidly and new media platforms and portable devices emerged periodically, it was likely that new companies would enter the marketplace and begin to compete with Sirius XM's programming and services.

Advanced In-Dash Infotainment Systems

In 2014, nearly all automakers had deployed or were in the process of installing integrated multimedia systems in the dashboards of their models. These systems could combine control of audio entertainment from a variety of sources, including AM/FM/HD radio broadcasts, satellite radio, Internet radio, smartphone applications, and stored audio, with navigation and other advanced applications such as restaurant bookings, movie show times, and stock-trading information. Internet radio and other data were typically connected to the system via a Bluetooth link to an Internet-enabled smartphone, and the entire system could be controlled via dashboard touchscreens or voice recognition. These systems significantly enhanced the attractiveness of the services of Sirius XM's Internet-based competitors by making such applications more prominent, easier to access, and safer to use in the car. Similar systems were also available in the aftermarket for automobile accessories and were being sold by retailers.

Direct Broadcast Satellite and Cable Audio

Such providers of TV programming as DirecTV, Dish, Comcast, Time Warner, Charter, and others typically included a package of audio programs (mostly music) as part of their packages of video programming services. Customers generally did not pay an additional monthly charge for the audio channels, and such programming was accessible only at the fixed locations where customers' TVs were connected.

Providers of Traffic News Services

A number of providers competed with Sirius XM's traffic news services. Clear Channel and Tele Atlas had partnered to deliver nationwide traffic information for the top-50 markets to in-vehicle navigation systems with RDS-TMC traffic reception capability; RDS-TMC was the radio broadcast standard technology for delivering traffic and travel information to drivers. Moreover, the market for in-dash navigation systems was being invaded by increasingly capable smartphones that provided advanced navigation functionality, including live traffic information. Android, BlackBerry, and Apple iOS-based smartphones all included GPS mapping and navigation functionality, often with turn-by-turn navigation.

GOVERNMENT REGULATION

As operators of a privately owned satellite system, Sirius XM was regulated by the Federal Communications Commission under the Communications Act of 1934. Any assignment or transfer of control of the company's FCC licenses had to be approved by the FCC. Sirius XM's licenses for its five Sirius satellites expired in 2017; its FCC licenses for several XM satellites expired in 2014 and 2018. Management anticipated that, absent significant misconduct, the FCC would renew the licenses to permit operation of these satellites for their useful lives and would also grant a license for any replacement satellites. The FCC had established rules governing terrestrial repeaters and had granted Sirius XM a license to operate its repeater network. Sirius had to obtain FCC certification for all of its satellite radios.

Sirius XM was required to obtain export licenses from the U.S. government to export certain ground control equipment, satellite communications and control services, and technical data related to its satellites and their operations. The delivery of such equipment, services, and technical data to destinations outside the United States and to foreign persons was subject to strict export control and prior approval requirements.

IMPORTANT NEW DEVELOPMENTS

In October 2013, Sirius XM announced that its board of directors had approved an additional $2 billion common stock repurchase program to be funded by cash on hand, future cash flow from operations, and future borrowings. The company also announced that it had agreed to repurchase $500 million of common stock from Liberty Media and its affiliates in three installments, in November 2013, January 2014, and April 2014. These purchases were in addition to Sirius XM's recent repurchases of 476.5 million shares of common stock at an aggregate cost of approximately $1.6 billion.

Meanwhile, Liberty Media brought its ownership of Sirius XM common stock to about 53 percent of the shares outstanding, and three new directors chosen by Liberty Media were added to Sirius XM's board. This resulted in a "change of control" at the corporate level since Liberty Media became the controlling owner. On January 3, 2014, Sirius XM's board of directors received a nonbinding letter from Liberty Media Corporation proposing a tax-free transaction whereby all outstanding shares of Sirius XM's common stock not owned by Liberty Media would be converted into the right to receive 0.0760 share of Liberty Series C common stock, which would have no voting rights. Liberty Media indicated that immediately prior to the conversion, it intended to distribute, on a 2-to-1 basis, shares of its Series C common stock to all holders of record of Liberty Media's Series A and B common stock. Liberty Media also indicated that it expected that upon the completion of the proposed transaction, Sirius XM's public stockholders would own approximately 39 percent of Liberty Media's then-outstanding common stock. Sirius XM's board of directors formed a special committee of independent directors to consider Liberty Media's proposal.

In addition to its 53 percent ownership of Sirius XM, Liberty Media owned interests in a broad range of media, communications, and entertainment businesses, including:

- 100 percent ownership of the Atlanta National League Baseball Club and TruePosition, Inc., a global leader in location determination and intelligence solutions that help protect citizens, combat crime, and save lives.
- 67 percent ownership of MacNeil/Lehrer Productions, producer of *The PBS NewsHour,* documentaries, interactive DVDs, civic engagement projects, and educational programs.
- Minority interests in Charter Communications (27 percent); Live Nation Entertainment (26 percent)—the largest live entertainment company in the world; Barnes & Noble (17 percent); Mobile Streams (16 percent)—a global mobile content retailer of full-track downloads, ringtones, videos, graphics, and games; Kroenke Arena Co. (7 percent)—the owner of the Pepsi Center, a sports and entertainment facility in Denver, Colorado; and Crown Media Holdings (3 percent)—the owner-operator of the Hallmark Channel and the Hallmark Movie Channel.
- Small common stock investments (generally 1 percent or less) in CenturyLink, Time Warner Cable, and media companies Time Warner, Inc., and Viacom.

Analysts speculated that Liberty Media's offer to Sirius XM shareholders—which they valued at $3.67 per share based on then-prevailing conditions—was predicated on strengthening its balance sheet and gaining access to Sirius XM's $1.1 billion in annual cash flows from operations, cash that it could use to join forces with Charter Communications in a bid to acquire Time Warner Cable (TWC). Charter had offered to buy Time Warner Cable for $127 in October 2013 and had upped its offer to $132.50 in January 2014; TWC had rejected both offers as grossly inadequate. Then in mid-February 2014, TWC agreed to be acquired by Comcast in an all-stock deal worth about $155 per share to Time Warner shareholders. Shortly thereafter, Liberty Media turned its attention to making some acquisitions in Europe and, on March 13, 2014, officially announced it was abandoning its offer to acquire all of the outstanding shares of Sirius XM. A day later, Sirius XM issued a press release saying that it was resuming the common stock repurchase program previously announced in October 2013.

Decline in the Number of Subscribers, Fourth Quarter 2013

On February 4, 2014, Sirius XM announced its financial and operating performance for both full-year 2013 and the fourth quarter of 2013. While the company's performance was on the whole positive, Sirius XM's reported decline in the number of subscribers from the third quarter to the fourth quarter was a red flag that quickly caught the attention of stockholders and industry analysts. Gross subscriber additions of 2,409,804 in Q4 of 2013 were about 155,000 below the gross subscriber additions of 2,561,175 in Q3 of 2013, but a big jump in subscriber deactivations to an all-time record high (up 384,493 over the prior quarter) led to a net decline of 22,756 subscribers in the 2013 fourth quarter—recent quarterly subscriber data for Sirius XM are presented in Exhibit 5.

Several factors contributed to the negative subscriber growth in 2013's last quarter:

- Sirius XM began paying automakers lower subsidy rates per satellite radio–equipped vehicle. Indeed, the lower subsidy payments resulted in subscriber acquisition costs of $124 million in the fourth quarter, or just 12 percent of revenue, the lowest percentage in the company's history. And subscriber acquisition cost per gross subscriber addition was a record low $44, which was 18.5 percent below the $54 average for the fourth quarter of 2012.
- A major automaker shifted to unpaid trial subscriptions in Q4 of 2013, accounting for most of the 434,240 decline in paid promotional (trial) subscriptions from Q3 to Q4.
- The new vehicle conversion rate from trial to self-pay was only 42 percent in Q4, as compared to the normal 45 to 46 percent rates that prevailed during 2010–2012 (see Exhibit 3).

It was unclear whether the jump in deactivations reflected resistance to the costs of subscribing to one of the company's numerous subscription plans. Subscription prices, which ranged from $6.99 to $16.99 per month until mid-2011, were increased shortly after the agreement with the FCC to not raise prices expired in July 2011—the base rate was increased

EXHIBIT 5 Quarterly Gross Subscriber Additions, Deactivated Subscribers, and Net Subscriber Additions, Sirius XM Satellite Radio, 2011–2013

	Gross Subscriber Additions	Deactivated Subscribers	Net Subscriber Additions
2011			
Quarter 1	2,052,367	1,679,303	373,064
Quarter 2	2,179,348	1,727,201	452,147
Quarter 3	2,138,131	1,804,448	333,683
Quarter 4	2,326,174	1,783,208	542,966
2012			
Quarter 1	2,161,693	1,757,097	404,596
Quarter 2	2,481,004	1,858,962	622,042
Quarter 3	2,421,586	1,975,665	445,921
Quarter 4	2,553,489	2,018,536	534,953
2013			
Quarter 1	2,509,914	2,057,024	452,890
Quarter 2	2,655,488	1,939,726	715,762
Quarter 3	2,561,175	2,048,067	513,078
Quarter 4	2,409,804	2,432,560	(22,756)

Sources: Company 10-Q reports; and company press releases of fourth-quarter and full-year results, February 5, 2013, and February 4, 2014.

by an average of $1.54. Another $0.50 increase went into effect in January 2014, resulting in subscription plan prices ranging from $9.99 to $18.99 per month. But many new vehicles had in-dash connections that enabled drivers to plug in smartphones and other mobile devices and listen to downloaded or streamed music from sources other than Sirius. However, the data plans that drivers had for their connected devices could often result in paying more to listen to streamed programs than the cost of a Sirius subscription, especially if they listened to a lot of hours of streamed programming in their vehicles each month.

The performance of Sirius XM's stock price in the first three months of 2014 was disappointing. After jumping to $3.86 per share in the days following Liberty Media's offer on January 3, 2014, to acquire all of the remaining shares of Sirius XM's common stock that it did not already own, Sirius XM's stock price drifted down to $3.43 the day after the company announced its fourth-quarter and full-year results for 2013. On March 31, 2014, the company's stock price closed at $3.20 per share.

Sirius XM's Guidance for 2014

In announcing the company's full-year 2013 financial and operating results on February 4, 2014, Sirius's management reiterated its guidance for the company's performance for 2014:

- Revenue of over $4 billion.
- Net subscriber additions of approximately 1.25 million.
- Income from operations of approximately $1.30 billion
- Free cash flow approaching $1.1 billion.

This guidance was reaffirmed in an April 24, 2014, press release.

ENDNOTES

[1] Alexander Eule, "Sound of Success," *Barron's*, November 25, 2013, p. 26.
[2] Ibid.
[3] Ibid.
[4] Letter to Shareholders, 2012 annual report.
[5] Eule, "Sound of Success."