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XM Satellite Radio Q1 2007 Earnings Call Transcript

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XM Satellite Radio Holdings Inc (XMSR)
Q1 2007 Earnings Call
April 26, 2007 10:00 am ET

Executives

Joe Titlebaum - General Counsel
Hugh Panero - CEO, Director
Gary Parsons - Chairman
Nate Davis - President and COO

Analysts

Robert Peck - Bear Stearns
James Raquel - Lehman Brothers
David Bank - RBC Capital Markets
Jonathan Jacoby - Banc of America
Eileen Furukawa - Citigroup
Mark Wienkes - Goldman Sachs
Benjamin Swinburne - Morgan Stanley
Craig Moffett - Sanford C Bernstein & Company
Lucas Binder - UBS

Presentation

Operator

Good morning My name is Russell and I will be your conference operator. At this time I would like to welcome everyone to the First Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question and answer session (Operator Instructions). Thank you

Mr Titlebaum you may begin your conference

Joe Titlebaum

Hello everyone This is Joe Titlebaum, General Counsel of XM Satellite Radio Before we begin our prepared remarks, I would like to remind everyone that certain information on this call may contain forward-looking statements Due to a number of factors, our actual results may differ materially from those projected in such forward-looking statements

Those factors include future demand for the company's service, the company's dependence on technology and third party vendors. The potential need to increase marketing expenses to meet competition or address changing marketplace conditions. And the potential need for additional financing, as well as other risks described in XM Satellite Radio Holdings Inc. Form 10-K filed with the Securities and Exchange Commission on March 1, 2007, and the rule 14-A-12 and 8-K filings more recently made with the SEC. Copies of these filings are available online and upon request from XM Radio's Investor Relations department

I will turn the call over to Hugh Panero, CEO of XM Satellite Radio

Hugh Panero

Thank you, Joe I would like to welcome all of you to XM's 2007 first quarter call. On the call with me today are Gary Parsons, Chairman; Nate Davis, President and Chief Operating Officer, and Joe Euteneuer, the Chief Financial Officer

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Before I begin my comments on the first quarter, I would just like to note that the company recently surpassed 8 million subscribers, quite an achievement in something that many thought was unthinkable when we started the business a number of years ago. That's the first quarter. We are pleased with our overall results.

As a quick summery, our OEM growth remained on track and we will be ramping throughout 2007 and 2008 During the quarter, our OEM business was further strengthened as we signed 10 year contract extensions with Toyota and Honda We experienced continued revenue growth and leveraged our fixed cost

Our churn rate was stable, it's slightly under 1 8% driven by an overall improvement in our marketing efforts We experienced incremental retail share increases in the first quarter of 2007 compared to the fourth quarter of 2006. Although the overall retail segment is lower year-over-year.

In April, we launched our third season of Major League Baseball, our flagship sports property, and we strengthened our college sports offering adding the South Eastern Conference featuring very large southern schools to our extensive college sports lineup which enhances our overall focus on the display sports side.

We also provided our subscribers with enhanced content, extensive coverage of the Grammy Awards, micro channels and renewal of the Bob Dylan agreement, and improved customer service all of which Nate will talk about as well. In February, we completed the XM-4 satellite sale leaseback transaction, and we were also pleased to see the recent dismissal of Prejudice of the shareholder lawsuit filed against us in mid-2006

While one solid quarter does not make a trend, our first quarter performance reflects the fact that we have moved decisively to address a number of business challenges and those efforts have begun to yield results

I'll return before the Q&A to provide everyone with a regulatory update as it relates to the pending merger with Sirius, but now I would like to turn the call over to Nate, who will go through our operational initiatives and performance in more detail. Nate?

Nate Davis

Thanks, Hugh When we spoke to you on the 2006 third quarter Earnings Call, there were a number of areas that we said we would address, including, strengthening our OEM relationships, improving our retail performance, improving churn and customer service, using our marketing dollars efficiently, keeping our fixed costs under control, and raising conversion rates. Our first quarter results demonstrate that our initiatives are beginning to work.

We signed Toyota and Honda to new ten-year factory installation deals as Hugh mentioned. Our monthly NPD data and reports show that we gained retail share in February and in March, and as Hugh mentioned that churn continues to be stable, is slightly under 1 8%

Total marketing costs have remained under control and we have not chased the retail share or absolute growth at the expense of economic The one area where we did not see improvement is in our conversion rate, which was slightly below our expectations in the first quarter at 51.5%, down slightly, compared to 52.4% in the fourth quarter of 2006

We expect the conversion rate to stay in the low 50% range in the near future. However, like our approach to customer service, to churn and to the aftermarket, we've taken an internal challenge to improve conversion rate.

In the first quarter XM's OEM performance was strong with 522,000 gross additions and 207,000 net additions In addition to these ten-year deals with Honda and Toyota, we've recently announced that we've signed a certified pre-owned re-marketing program with Honda, which compliments the deal we signed with Acura in the fourth quarter of 2006

XM will be a standard factory-installed feature on all 2008 Infiniti models, and the all new Hyundai Veracruz midsize crossover vehicle will now have XM as standard factory installed feature. This is in addition to Hyundai's previously announced Azera, Elantra, Santa Fe and Sonata models

And Lexus' LX 570 will incorporate XM Radio and XM NavTraffic as standard factory installed feature. This is the second

Lexus rollout of XM NavTraffic as a standard feature.

And finally, GM produced its 5 millionth XM equipped vehicle in January.

Turning to retail, during the quarter we saw improvements in our share according to NPD data. That being said, it is important to point out that this category remains soft year-over-year as Satellite Radio experiences competition from a range of audio entertainment products.

In the first quarter, we added 331,000 gross additions and 60,000 net additions at retail. We saw noticeable improvement in our NPD retail share during the first quarter with over 50% share in some weeks in March and overall share of 47% in March.

Next, I would like to spend a minute on the refinement we made last year in our marketing approach, as that approach affects both retail and OEM.

As an entertainment company we believe our entertainment product connects with listeners on a very personal basis. And we needed to remind people that very special personal connection, both to help existing listeners remember why they should stay with XM, and also to help potential listeners understand the value of XM.

And while we only completed two quarters using our strategy has started to pay dividend. It all started with our new ad campaign last year to remind people that there are 170 channels that will turn you on. This award winning campaign created an exciting buzz about XM, and as a result, XM's unaided brand awareness recently hit an all time high in the first quarter of 2007.

Promoted great radio is fundamental to our business. But we are not merely marketing radios, we are marketing our content. So you will see few marketing campaigns centered on radio feature. You will see our marketing efforts centered on programming in order to form that emotional connection I talked about.

You have begun to see this new approach with our presence at the Grammy's and are being totally involved in the opening day of Major League Baseball. Linking our marketing programs more tightly to specific listeners who enjoy specific content, we hope to drive more OEM conversions as well as more retail sales.

One key target of our segmented marketing approach is a displaced sports fan. The New York Beth (Pan) who lives in LA, one of the thousand college alumni who want to follow their own more modest football or basketball programs but can't

XM satisfies the needs of this displaced sports fan. Major League Baseball has been the most successful example to this date. 78% of XM subscribers who are Major League Baseball fans consider themselves to be a displaced fan.

Our Major League Baseball campaign is our biggest, most innovative and integrated marketing effort to date. Our message of every team, every game, everywhere is designed to clearly communicate the XM benefit of play-by-play of every Major League game

We've used everything from T.V., online and print-ads to bio-marketing to direct marketing and sweep stakes, all centered on the value our content brings; not on the device on which you receive the content.
Another example of where we can reach the displaced sports fan is the college sports. During the first quarter we added the Southeastern Conference to our channel lineup This addition of the Southeastern Conference gives us five of the six major college sports conferences and makes us definitive leader in college sports.

This summer and this fall expect to see our marketing programs centered around college sports and mirroring the integrated campaign you've just seen with Major League Baseball.

On XM, you can now hear a wide variety of college sports games from the Southeastern province and the Big East, the PAC-10, the ACC and the Big-10. We will leverage college sports content not only to acquire new subscribers, but also to listen to improve listener satisfaction, and since customer service tell us that 24% of our subscribers would like even more college sports, we think we've hit a home run with the addition of the Southeast Conference.

Our new segmentations based marketing strategy is broader than just targeting this displaced sports fan. For example, we used XM content headline by artists like Quincy Jones and Snoop Dogg to promote Black History Month, and to market the African- Americans in February and March.

Our programming also tied us to marketing with low-cost, high-style promotions like a free Beyonce CD, with every radio sale of Circuit City and the Beyonce concert tickets sweepstakes.

Our media plan featured ads on Black Entertainment Television on bet com, and these ads received some of the highest click-through rate we have ever seen at XM Our Black History Month promotion was a cost effective way to reach an important segment And you can expect in the coming months to see the same kind of focus on the Hispanic marketplace.

We are also engaging in deepening our relationships with other existing subscriber groups, through something we call micro channel.

Can you hold it please for a moment? We are having technical difficulties here.

Okay. We are back I am sorry for the interruption. I've talked about these micro-channels and want to expand on that a little bit. These are channels we launched on a temporary basis to celebrate holidays and special events. For example, in December, we offered Christmas Music Stations and a (Chanukah) music channel. We were surprised and also very pleased that how many of our subscribers just love these channels.

During the first quarter and celebration of St. Patrick's Day, we offered XM Green, a channel devoted to Irish music. And in honor of the opening day of baseball, we created a micro-channel that played hundreds of songs just about baseball.

On the music front, we had extensive coverage of the Grammy Awards in February, and also signed a new multiyear contract to extend our critically acclaimed Theme Time Radio Hour with Bob Dylan.

And finally, Oprah & Friends. The Oprah & Friends channel has significantly enhanced the overall XM content offering. Oprah & Friends is extremely popular with women and is now one of the top ten ranked channels in the news and talk category on our network. The Oprah Channel also provides more advertising revenue than any other channel on the XM lineup.

Stay tuned, because you will see much more focused programs talking about, talking to specific audiences that seeks specific great audio entertainment. I believe this marketing approach will continue to pay dividends as we expand on the foundation that we've already built.

Now I would like to talk to you about churn in customer service. As good as our content is, it takes a lot more than content to keep churn in check, and we continue to look for innovative ways to improve our overall ambient customer experience. This is at the forefront of everything we do.

And in the first quarter, we saw XM self pay churn continue to be at slightly under 1.8%, and although we indicated on the last quarterly conference call that churn might actually be up in the first quarter, our programs allowed us to decrease churn slightly.

Customer satisfaction, as measured independently, of one of our major OEM partners shows four consecutive months of improvement. Now, we can always do more to improve customer TR, but as evidenced from our churn stats and our customer care stats we've achieved strong results. And we are focused on a number of items, both large and small, which taken together are resulting in significant better performance in the customer care area.

These efforts go from improving the quality and the timing of our customer mailings. The onsite staff has now manage all customer care centers through our major initiative that is moving more calls on to U.S. based call centers, and these U S. based call centers now have the technical skills to handle the more complex issues such as OEM needs, high-end radio support like the NO and second level technical support We recently opened centers in the Hillsboro, Virginia and Huntington, West Virginia to handle long through calls, and after extensive new training we've already begun to migrate calls to these new centers.

For special groups of customers we have proactive programs For example, in advance of determination of our relationship in NASCAR, we took a proactive, integrated marketing communications program, geared towards those subscribers who are also NASCAR fans.

This campaign has been successful to date in reducing potential deactivation, related to NASCAR by highlighting our strong music content and other XM content related to motor sports. Another way of engaging our existing and potential customer base is through our website, which we re-launched last fall, if you remember. The majority of our website users are subscribers who are getting more and more engaged with XM through the web. They are checking out upcoming content, managing their account online, extending their XM experience by listening online as well, and our online metrics have improvement dramatically.

We have more than a 100% increase in the average time spent on the site, a 20% increase in the number of people accessing channel pages for content, and a 15% increase in online activations.

As we move forward in the second quarter, we remained focused on executing against these key priorities and operating our business as a standalone entity. We intent to build on our successful first quarter performance in the aftermarket, continue to rollout all the OEM partners, and continue to manage churn.

We are going to rollout two new plug-and-play radio by mid summer, and cost effectively simulate the consumer demand and retail. And we are going to finish the customer care initiative to move more calls onshore.

But there is a lot more to be done, but we are very, very pleased with our first quarter results, and we can now see that our new initiatives has been put in place over the last six months are beginning to work. I would like to turn the call over to Joe now. Joe?

Joe Titlebaum

Thanks Nate. Good morning everyone. As Hugh and Nate said earlier, we are pleased with our first quarter performance. The financial highlights of the first quarter were strong revenue growth driven by subscriber growth and stable ARPU, controlled fixed costs excluding merger and legal costs.

Strong pre-marketing EBITDA and adjusted operating loss performance, and liquidity enhancement through the satellite sale lease back transaction.

Total revenues in the first quarter increased 27% to $264 million compared to $208 million in the first quarter of 2006.

Subscription revenue for the quarter increased 26% to $236 million from a $188 million in the first quarter of 2006. The two key components of our growth in subscription revenue are growth in subscribers, which Nate has already discussed and ARPU.

XM's subscription ARPU for the first quarter was $10.15, up $0.08 from the first quarter of 2006 including an increase in data services ARPU along with the decline in the use of mail-in rebates which are counted against revenue rather than in SEC.

Our subscription margin was 68% in the first quarter. This compares to 67% in the fourth quarter of 2006 and just under 70% in the first quarter of 2006. As Nate mentioned, and as we previously discussed, one of the ways we will improve customer satisfaction in 2007 is through onshoring a portion of our customer care. This strategic investment in onshoring care will however have a slightly negative impact on our subscription margin in 2007.

Fixed cost for the first quarter were $125 million compared to $102 million in the first quarter of 2006.

The year-on-year increase in fixed cost includes approximately $8 million in merger related expenses which consist of legal, lobbying and financial advisory expenses; approximately $4 million in other legal and regulatory expenses, $4.4 million is associated with the addition of Oprah & Friends channel and $2 million increase in stock-based compensation.

Our pre-marketing EBITDA in the first quarter of 2007 increased 12% to $56 million from $50 million in the first quarter of 2006. The year-over-year comparison would have been better without the $8 million in merger expenses just mentioned. This financial performance is driven by our ability to grow revenue while leveraging our fixed cost base.

Our continuing growth in pre-marketing EBITDA is a solid indicator of our ability to generate positive cash flow overtime and to attain self-sustainability Just a reminder, we calculate pre-marketing EBITDA by adding back total marketing, excluding retention and support to adjusted operating losses defined in the financial attachments to the earnings press release.

Total marketing expenses declined 13% in the first quarter of 2007 to $93 million compared to $107 million in the first quarter of 2006. The year-over-year decline in marketing expenses should be viewed as a trade-off between our continued control of SAC and CPGA and the rate of gross additions.

First quarter 2007 SAC and CPGA were $65 and $103 respectively compared to the first quarter of 2006 SAC and CPGA of $59 and $93. First quarter 2007 SAC included $5, which can be attributed to inventory related charges. These charges are included in the line item on the P&L cost of merchandise.

Other inventory or manufacturing related expenses may be required in coming quarters, as we transition to our newer products. These additional charges could increase CPGA cost

As Nate mentioned earlier, all of our factory installation OEM partners will increase production of XM enabled vehicles during 2007, weighted towards the second half of the year. We incur substantially upfront radio installation costs before recognizing customers from our new partners as subscribers. As a result, we anticipate an increase in SAC and CPGA during the second half of 2007. It can take more than six months from production for those cars to move through inventory and trial periods to becoming self-paying customers.

Remember, that XM has always recorded installation expenses in advance of accounting actual subscribers. Thus, expenses are a function of how we structured our OEM deals and our strong OEM factory installation growth through 2007 and 2008. Over the next several quarters, all of our partners are rapidly increasing production of XM enabled vehicles. For example, Hyundai began factory installations in the fourth quarter of 2006. We are only now beginning to see our first Hyundai customers, six months after the factory installation program was launched.

We anticipate that GM production will increase to $1.8 million, XM installed cars in 2007 with the majority of that production increasing weighted to the second half of the year. Nissan is expected to begin large scale XM factory installations in the

second half of 2007.

Finally, beyond its Lexus brand vehicles, Toyota expects to ramp factory installations of the Toyota brand beginning in 2008. This reflects Toyota's goal of factory installing 1 million vehicles with XM equipment in 2010.

Our quarterly adjusted operating loss, formerly referred to as adjusted EBITDA was $27 million including $8 million in merger-related expense, compared to an adjusted operating loss in the first quarter of 2006 of $49 million, an improvement of $22 million or 45%.

XM's quarterly revenues over the same period grew $56 million. As the sign of our operating leverage, the 27% increase in our revenue resulted in a 45% reduction in our adjusted operating loss.

Our GAAP net loss for the first quarter was a $122 million. This reflects an 18% improvement from the $149 million loss that we recorded in the first quarter of 2006. The first quarter of 2007 included $8 million in merger related expenses, and $3 million in de-leveraging charges from the early pay down of mortgages related to the XM-4 sale leaseback. The first quarter of 2006 loss included $18 million in de-leveraging charges.

We ended the first quarter with $319 million in cash and fully availability on our $400 million credit facilities resulting in total available liquidity of $719 million We began the quarter with $218 million in cash.

In February we added $244 million net proceeds from the completion of the XM-4 Satellite sale leaseback transaction. The two major cash expenses in the first quarter were $60 million prepayments in Major League Baseball for the entire 2007 season, and $90 million in Satellite capital expenditures largely associated with our XM-5 backup Satellite which is still under construction We believe that the first quarter will be our largest cash usage quarter for the year

We want to reiterate our guidance for 2007 for subscribers and revenue. Guidance for subscribers is 9 million to 9.2 million with higher seasonal growth in the latter part of the year, and subscription revenue should be in the billion dollar range.

While we see improved cash flow from operations in 2007, full year positive cash flow from operations will happen in 2008. Our refined CPGA guidance for 2007 is in the range of a $111 and $114 primarily due to the impact of new OEM factory-installed volume ramp and the need to continue stimulating the retail distribution channel

Our guidance on 2007 adjusted operating loss is in the range of $170 million and $180 million excluding merger related cost, which were $8 million in the first quarter and any legal settlement cost There can be no assurance on how the merger transaction, the regulatory approval process and other related matters will affect this guidance and other aspects of our business operations. However, we are committed to minimizing the impact of the merger on the operations. Hugh

Hugh Panero

Well, as you can see, we continue to operate XM as very much standalone company, but I like to spend a few moments to go over the regulatory process and update it as it relates to our pending merger with Sirius.

We filed our Hart-Scott Rodino application with the Department of Justice on March 12. On April 12th we received a second request for additional information from the Justice Department which was expected. We filed our merger application with the SEC on March 20th, and we anticipate that the Commission will issue a public notice in the near future that sets a schedule to comment on the merger. Once the Commission issues a public notice, it will trigger a comment period followed by a reply period. Four congressional hearings on the merger have been completed; numerous news papers have published editorials including a featured editorial in the Wall Street Journal which is very positive this weekend noting the NAB's tenth cycle competition and prevent the creation of a strong combined company.

We continue to believe that we'll also probably receive the necessary approvals to proceed with the merger, and that it will be a big win for both consumers and shareholders. We also need to emphasize that even without a merger XM is well positioned to be a strong and enduring leader in the audio entertainment category.

Just to summarize, the first quarter and closing before our Q&A is that year-over-year we experienced strong revenue growth. Our losses narrowed During the quarter, we improved our retail performance, experienced strong OEM gross additions, extended our distribution agreements with Toyota, Honda, enhanced our customer service, maintained our churn rate at approximately 1.8% for the third consecutive quarter, and strengthened key financial metrics of our business and this is a result of many initiatives that we put in place over the last several quarters

I would now like open up the call for questions and answers.

Question-and-Answer Session

Operator

(Operator Instructions). Your first question comes from the line of Robert Peck.

Robert Peck - Bear Stearns

Hi everybody. I just want to dig a little further on some of the conversion rates stuff. First of all, could you talk about a little bit more on what's actually driving the dip in the conversion rate, and sort of what portion of it is a function of just further penetration in models in cars across the various lines? And when do you sort of see that stabilizing? And maybe Joe you could sort of address the last part of this question, which is, what level can this sort of trend to you over time; how far can it dip down and still have XM fully funded?

Nate Davis

This is Nate Davis speaking. Hi, Robert. First of all conversion rates, as we talked about we think it will stay in slightly above 50% range, and I think we have to keep in mind that the changes here, the fluctuations we've seen have been between 52.5 and 51.5 or 53 or so and 52. So we are not seeing a dramatic dip; we are not happy with the number going down, rather it'll go up. But remember that we are not seeing a 10 point drop here. We're just seeing a couple of point fluctuation.

We do have a number of programs that we focus on. Since this is primarily GM and Honda, we have some dealer level incentives and improvement programs that we feel are with the dealers. GM and Honda have agreed to do some promotions with us, and we think that overtime these promotions will all make a difference.

We can't predict they will impact us in the next 30 or 60 or 90 days, but we do think overtime these will start to make a difference. So I don't think we've seen a dramatic drop, but I think what we are really seeing here is the fluctuation; when do we think the penetration levels, how will that impact it?

First of all Hyundai is a manufacturer that is most aggressive in getting it in all of the cars. They've been very, very cooperative with us in working on it, and some of the early data we've seen says that that it's not going to -- we're not going to see a drop in what we call post-trial retention just based on the penetration levels

So I think that we'll be able to keep this stable as we've said. Joe?

Joe Titlebaum

And Rob, in regards to your last question, remember you are talking about the universe of cars on trial is roughly a half a million. So, therefore, one percentage point is only about 5,000 cars. So, we clearly have plenty of room on the liquidity standpoint in regards to any negative impact and with regards to conversion rate.

Robert Peck - Bear Stearns

A quick follow-up here, historically you've mentioned the 2010 guidance of high-teens sort of subscribers. Do you still hold to that now or you've adjusted that number downward somewhat?

Nate Davis

No, we still hold to it.

Robert Peck - Bear Stearns

Thanks guys.

Operator

Your next question comes from the line of Vijay Jayant

James Raquel - Lehman Brothers

Hi, it's James Raquel for Vijay. Good morning. I wanted to touch on two topics, first of all, on the used car re-marketing program. Can you give some color around this particularly either incentives for the sales people who sell new cars, and the preliminary idea what conversion rate for those cars run versus non-used car re-marketing program, used cars and what stock looks like? And secondly on the family plan, you are up to about 23% of subs on the family plan. Is there a point where you would like to see that cap out? Have you considered raising or closing the gap between the family plan and the proprietor package? Thank you

Nate Davis

Well, first on the remarketing program. There are no incentives for the individual sales people, but there are intensives for each car manufacturer. Obviously, as the relationship goes, they get some benefit from this cargo, even we signed up for XM services as well. So they are intended to make their customers satisfied and also some economics in it to have these cars re-marketed. So, we are getting a lot of support from GM -- I am sorry, from GM and from Honda and companies to do the re-marketing efforts.

So I think that the economics thing is not what's driving in and as much as the fact that satisfaction that their customers get knowing they have these options. That's really what's driving the effort. You ask a lot of questions there at once and so -- I heard the one clearly about remarketing both the second hand --

Hugh Panero

I think the family plan, actually Joe, you can address it, but the family plan, we think, is a very attractive component of our service that actually demonstrates that when people get the service they want to extend it into deeper into their life's and their car, and we are very pleased with where the rate is right now with the family plan, and we hope to hold it there. And if we actually get more subscribers to it we think that's fine, and then also it adds to our ability to deliver more listeners as part of our advertising business as well.

Gary Parsons

One addition, and this is Gary, one additional piece that just is an interesting side light on the family plan subscriptions, as every analyst has noted this is becoming increasingly an OEM centric driven model, but one interesting highlight of that is every time you get an OEM Radio that cannot be moved outside of that car, if you have a happy subscriber then they are actually looking to use it in other locations and that does tend to drive some second subscription family plan effort whereas if its an aftermarket subscriber that may buy a plug-and-play radio they can solve some of that need by moving the radio between the home or car or office So, you know, I think it's a positive aspect to it as well to.

Nate Davis

And so, it will all be just a little bit to that, this is Nate speaking. One last thing is the reversal of what Gary talked about, which is those people let it experience the service your aftermarket, once they buy a new car what we are finding is that when they buy a new car the conversion rate for those customers is very high because they have experienced it sort of So, we think the channel is trying a great thing James did we answer all three of your questions?

James Raquel - Lehman Brothers

I was just wondering if you have an idea on conversion rate or any preliminary idea on conversion rate for the used car re-marketing program and what the rate is for cars that don't go through such a program?

Nate Davis

It's very early in the program yet, so we really don't have any stats that we can report.

James Raquel - Lehman Brothers

All right. Thank you.

Operator

Your next question comes from the line of David Bank.

David Bank - RBC Capital Markets

Thanks. Good morning. Two questions for you, the first one is about, I think two conference calls ago, you guys talked about how, when you started ramping the new OEMs versus from early GM and Honda, that you are going to separate your promotional bucket into two. Those OEMs that were subsidizing the subscriptions to generally to kind of 666 or some odd number per month, and those that were being wholly subsidized by XM. So, and that you would disclose in the press release or disclose somewhere, while they were not paying subscribers what the number of OEMs ads from that category is, so I guess looking for a kind of a follow-up on that, and can you give us a sense of what the gross ads were from Hyundai and from Toyota and Nissan, who are, I'm assuming are in that bucket?

The second question is can you give us a sense of with respect to your content contracts, the long-term contracts including both the big personalities and then on the sport side, do any of those contracts have changed your control provisions that would impact potentially the pricing of the contracts in the event of a merger? Thanks.

Nate Davis

Hi, David, this is Nate speaking. I'll let the other guy address the contracts, but let me first address this question about reporting. As you know, we don't breakout subscribers down below the OEM versus retail level for a number of reasons, probably the biggest reason being competitive. Each of the car manufacturers would ask us to keep a lot of that information confidential, so we don't break that out.

What we will do is, over time, we'll be looking at the difference in conversion rates, because some people are on a bill pay trial and some are not. So we'll look over time at that reporting, but we are not prepared at this time to split out the number of subscribers we get from new car manufacturers versus GM and Honda. That's the level of detail we've promised we will not yet do, though.

Gary Parsons

Hey, and David also just to make sure because; this is Gary. It wasn't clear to me from your question that there may not have been a misinterpretation relative to promotional subscribers. The only promotional subscribers that ever appear in our numbers, I mean the only, but there is only one promotional subscriber.

David Bank - RBC Capital Markets

Right.

Gary Parsons

And those are the ones that come where we are paid for the subscription by the car company and experience it that way. So when we -- there isn't a separate bucket that we have there, we don't even show those to the subscribers until all promotional subscribers at all if they are coming from Nissan or Toyota, Hyundai or someone else.

David Bank - RBC Capital Markets

Understood.

Gary Parsons

Till they actually become a self-paying customers. What we did indicate is that, once we've gotten some number of quarters of actual experience under our belt with some of those, then we will try to give some indicative indication as Nate was first indicating, say from Hyundai thus far, that it's been fairly positive. Some indication as to where those companies that aren't reported as promotional subscribers, how they are doing with post trial retention as well? Does that clarify it for you?

David Bank - RBC Capital Markets

Yes, that's what for two reasons Gary -- the reason of, two reasons are sort of hone down on it. The first is, yes, they are definitely not being counted as revenue generating subs, but for modeling purposes they are being counted as sort of the cost of the gross ad, right without the revenue. So, and the second reason is, we are just trying to get a sense of what the acceleration is in those newer -- in those newer OEM business. But yes, I think I am -- that's understood you are not, I misspoke, I don't' think anybody on the street interprets those autos that are not generating revenue as actual subscribers. I appreciate the clarification.

Gary Parsons

And since they come in only once they become self-paying subscribers and there is this six-month lag or so from the manufacturer of the car to actually becoming a self-pay subscriber, it's still going to be a couple of more quarters or so before you are going to start seeing the growth rate ramped that will occur there. The positive development of that obviously is that that gross addition continues in the net addition because, in fact, they've already gone through their post-trial retention.

David Bank - RBC Capital Markets

Okay.

Gary Parsons

Hugh, do you have guidance on that?

Hugh Panero

I think the last thing was a programming question?

David Bank - RBC Capital Markets

Right.

Hugh Panero

We're -- we don't have any like automatic triggers or payments in our deals to in case of a merger or extending the contract. Clearly we have to enter into a dialogue with some programmers with regards to carrying the content on another platform or, for example, Sirius carrying on all platform, which I think everybody is kind of clearly articulated.

We think it's a very positive thing for many of these content providers to do, because they basically, for example, we would get an opportunity to extend their products across the much larger base, and clearly have the help of the Satellite Radio business to use as another distribution mechanism for their valuable content.

So we are working through all those issues now.

David Bank - RBC Capital Markets

Okay. Thanks, guys.

Operator

Your next question comes from the line of Jonathan Jacoby

Jonathan Jacoby - Banc of America

Good morning. Most of my questions have already been asked, but clearly you have slowed down the rollout of new retail products. It sounds like even more so perhaps was portable, if you would have gone back a year ago the company was really excited, sort of felt that they were able to compete versus a lot of the audio entertainment option in the portable market. So, I guess my question is the slowdown, is this merger related? Is it post FM -- sort of re- modification that you guys do. Or is it sort of a reversal of strategy in the retail channel a little bit? Thanks.

Joe Titlebaum

Hi, Jonathan The answer to your question is no, its not merger related. We go through a product development cycle, and in the late 2005 or early 2006 period we had a significant effort going into the development of portable product But, at the same time, we lost some energy around plug-and-play, and we needed to reinforce our efforts in those areas. So, the reason you haven't seen a lot of new -- we have a portable market product is because we've been spending some time, number one, moving to the inventories we've got, we've got a lot out there especially with the SEC issues that happen. So we needed to move through that We've got some new products coming out in the mid-term of this timeframe. So we couldn't put, with so many products out at one time. We are not really chasing growth in the retail segment as well, and no wonder we had to put more of our dollars, promotional dollars, marketing dollars, product development dollars in the OEM sector. We haven't put as much as in the retail sector. So, we could have put more money in that area, but we really wanted to drive it into OEM, because OEM was growing so much. And those are really the reasons why you haven't seen a lot of new variable products.

Jonathan Jacoby - Banc of America

Thank you.

Joe Titlebaum

Welcome.

Operator

Your next question comes from the line of Eileen Furukawa

Eileen Furukawa - Citigroup

Hi. Thanks for taking the question Most of my questions also answered, but I have one quick question, which is, you talked about your negotiation in your new 10-year contracts with Toyota and Honda. I am just wondering, in your conversation with them did you get a better sense of why they continued to want us kind of go, especially Toyota, on a slower ramp up then their peers? And did you get a sense that they would consider moving to a more meaningful penetration like other competitors? And

just also you mentioned this independent study by a major OEM partner that shows customer satisfaction improving, was there any other data point in that study that we would find interesting? Thanks.

Nate Davis

I will start with the last question first on the study buy one of our OEM partners We are not at liberty to disclose the full study, but I don't think -- I think the rest of the study would be sort of uninteresting. The most important part of it was just seeing that customers believe that when they call in our current care centers they were getting their questions answered faster, they understood the process of getting converted better. So, I don't think there is anything else really of material information in the study that will impact you. So, that answers that question, you want to answer?

Gary Parsons

May be on the Toyota rollout or the overall Toyota initiative, I mean, if you watch Toyota's success in the market place it's hard to criticize what decisions they have made and how they like to move. They tend to do things in a very high quality manner, but they do it very strongly once they begin moving. Their own internal decision was they had about a three year rollout process to categorically go through their brands to reach full tight penetrations more in the '08- '09 type of a timeframe. And they are executing upon that, and they are executing upon it in a pretty high quality manner. Lexus was the first element of initiation this year moving into the Toyota brands next year, and then going full scale in '09 and '10 standpoint. We are very pleased with it, and certainly it may take a three-year cycle to get to a penetration level that Hyundai, or somebody else may get to in a two-year cycle; but different companies move at different paces.

Hugh Panero

I think if you look at General Motors, and they have moved out with Cadillac, if you look at Honda, and they move out with Acura, and then more recently Nissan has committed that they are moving a 100% on Infiniti, you are sure to see where Toyota goes. And it is pretty obvious which direction they'll go in terms of using Lexus as the division there. But, I think Gary has already said in terms of their speed of operation, I think they are really just focused on doing things their own way. But the other car manufacturers, I would mention that Nissan and Hyundai, and what we did learn from them is that some car manufactures like to trial their stuff first and then move out others, sort of want to go out at one time. Hyundai, as well Infiniti, clearly have been a more aggressive set. I think Toyota just have a different philosophy, and I think they can speak on that better than we can.

Eileen Furukawa - Citigroup

Okay Thank you very much.

Operator

Your next question comes from the line of Mark Wienkes.

Mark Wienkes - Goldman Sachs

Good day, good morning. There has been some noise mainly from some of the WCF coalition concerning the repeated network, I just wondered if you could give us an update on the current situation in light of the planned build out of that spectrum and any potential interference either way, and how your coverage footprint might look like once that is build out.

Gary Parsons

First, I would say that there have been noises about the repeater network from the WCF to sub-parties for a over a decade. And, in fact, there has been a long standing area where we went ahead and built out our network and put it into commercial operation. And virtually a decade after receiving their licenses, there really are no operating commercial networks on that front in the WCF. Some people would say that's warehousing spectrum, looking for better opportunities, we'll see. But we are working closely with the WCS carriers and trying to do the necessary testing to ensure that, we clearly understand and believe that our network is not any interference to them. I think that you will find that, that certainly has been the case historically. The network that we built is significantly smaller and significantly less powerful than the network that had been authorized by the FCC

So, I don't think you are going to see strong interference issues from that standpoint. And while the WCS carriers made a desire to have some greater flexibility, and the restrictions that they have in their own band emissions and power levels, we certainly would only come to a consensus for something that would protect our customer base from undue interference. It's just a fairly slow process, unfortunately

Mark Wienkes - Goldman Sachs

Okay. Thanks. And just one quick follow-up on the family plan subscriber talk from earlier. When you think about the merged entity, can you give me a thought of how you handled tiered pricing for planning plan subs?

Gary Parsons

Yeah. We had given it some thought, and I think the best thing to do at this point is to realize that we are going through a lot of conversations with FCC, DOJ etcetera. It's really not appropriate to try to negotiate in public like that. So, that's something we will talk about within as the time comes. But its really not something we should be opening up discussions on in this call. I am sorry but, I think, is just the right approach.

Mark Wienkes - Goldman Sachs

Thank you very much.

Operator

Your next question comes from the line of Benjamin Swinburne.

Benjamin Swinburne - Morgan Stanley

Hey guys, thanks for call, and thanks for taking the question. A couple of them, first, I think you guys have talked in the past about talking with the OEM partners about including the monthly fee for Satellite Radio as part of the lease plan, which I think would help your overall stats. Any updates on that at all, and any interest may be from some of the new partners like the Toyota in that marketing approach?

Nate Davis

Maybe the best way for me to describe this is to use history. There was a point in time when people asked us sort of in every call, are you making any progress with Toyota? Are they going to extend the agreement? Are they going to extend the agreement? We kept saying it's worked on, we think it's a good partnership, eventually it will happen

I think this is the same story We are making progress, I happen to know where we are, but when you are in the middle of negotiation you can't announce where we are. But I can tell you that, yes, we have got it, we have interest level. We have interest from more than more than one manufacturer, and when we get a final agreement signed we'll announce it. I can just – for credibility purpose I would just say it's the same way with as we did with the Toyota long-term agreement. These are things we really are having conversations about, and I think you'll see announcements in the near future.

Benjamin Swinburne - Morgan Stanley

Great. And a follow-up question more on the financial side. It looks like, Joe, if you pull out the securitization of the satellite I think you burnt roughly $150 million in cash in the first quarter, and you said that will moderate through the rest of the year because of the CapEx and the pre-pay on baseball.

Are you - do you think you are going to end the year without halving into the debt facilities that you have in place or is that something you likely do given the working cap trend?

Joe Titlebaum

It really depends on the working capital trends. I mean the realities are it's our goal never to catch the revolver if there is just standby liquidity, but obviously the prepayment from subscribers is a key portion of the short-term liquidity. So we just need to watch it as we go through the year.

Benjamin Swinburne - Morgan Stanley

Does the shift in gross ads away from retail to OEM part of your pre-pay?

Joe Titlebaum

No. Not at all.

Nate Davis

No.

Benjamin Swinburne - Morgan Stanley

Thank you.

Operator

Your next question comes from the line of Craig Moffett

Craig Moffett - Sanford C. Bernstein & Company

Yes. It's kind of step back a little bit from your subscriber guidance. You've obviously brought it way down over the last couple of years. As you, kind of zoom out a little bit from your cost structure, can you talk about, Nate how you think about right sizing the cost structure? What you can do beyond just kind of trimming marketing expenses and that sort of thing that can more dramatically change the cost structure to reflect the new subscriber reality of the business?

Nate Davis

Well, we can talk a little bit about that I think the number one thing that is probably the most dramatic is, and I wanted to be very careful about the way I say this. If the shift of expenses from the retail to OEM, and that happens in a lot of ways and in a lot of places from the amount of advertising we do, to the amount of subsidies we do, all of that the product development dollars that we spend, all of that is money that shifts toward OEM as we get more subscribers from OEM, to get a better return in there.

Now, at least I want to be very careful about what I say is because, I don't want you to get an impression that we are going to abandon the retail market We will not allow ourselves to be in a position where the retail share drops too much. We want to have a balance here between maintaining retail, but shifting more dollars over. And I think, that shift changes the cost structure of the company because more costs are directly associated with bringing on high volume of subscribers. So that's probably the biggest shift that we will do. The other shift will happen probably in the area of programming cost, and the way that shift works is that, we are not doing any major new programming magician. And I think that allow us to keep those costs flat while we grow revenue and that also increases the margins. I think Joe talked about in his script.

Gary Parsons

And Craig, the final thing on that, obviously is you quickly recognize that one of the largest flexible types of expenses is how much you spend to acquire new customers on that growth path. So when Nate earlier noted we are very pleased with the progress we've been making both at retail share and certainly with the OEM ramp, but we are being careful about the dollars that you spend to do it, I mean, not chasing that growth or chasing that share is the best strategy for sustaining a positive financial future.

Craig Moffett - Sanford C. Bernstein & Company

But Gary, I mean I understand, but the margin of return on new subscribers is still terrific because the operating leverage is so high. The issue is the six plus -- is the large relative to change in fiber trajectory. I guess, what I'm really wondering how much of the fixed cost are really flexible over the long term, and what can be done about them?

Gary Parsons

Yeah, you are correct in noting the fixed cost base that obviously that's the point that you have to get by, because let's face it, we are in the high 60s to 70% subscription margin on that, and that's a very positive increment for each additional one, but you have to calculate where are you going to be best through? What channel are you most effective at getting those customers and getting those customers that will stay for an extensive period at a low churn rate, clearly the rest of the fixed cost structure will just work on an ongoing management basis. Joe?

Joe Titlebaum

I think I would just like to -- I think we have time for one more question.

Operator

Your last question comes from the line of Lucas Binder

Lucas Binder - UBS

Hi, guys. Thank you very much. I'll just be quick with two quick ones, you mentioned earlier on the call about some of the products going through inventory and with some of your older products, should we expect to see some promotions with Father's Day and graduation coming up in the second quarter, which will help more and get rid of some of the older products, and maybe move into some new equipments in the second quarter and then one very quick follow-up.

Gary Parsons

The answer is yes You will see promotions in that area, and I would comment that there are two other major groups of partners we have, when it comes to moving retail radios, and that's the retail stores themselves, as well as, the distributors And we all three have an incentive to move as much product as we can So that becomes a joint agreement there to figure out who's going to fund what kind of promotions. So, when you see promotions come about, I just remind you that those promotions are not all coming out of the pocket of XM Sometimes retailers have decided on their own to promote products, sometimes distributors have decided to promote products, and you will see that happen in the Father's Day period.

Lucas Binder - UBS

Great. And then the only -- a quick follow-up for Nate. You mentioned efforts to improve the conversion rate, I know this has been discussed a lot, but can you talk about, has there been any changes in how you are working with your partners to actually build and move forward and start to see improvements in those conversion rates?

Nate Davis

Yes, well just, the one thing I mentioned before but I probably didn't stress strongly enough, is that we have a brand new dealer incentive program that we are very optimistic that it will make a pretty big difference With the partners, we have signed up for the first time, and that process has really worked well We've also had some new agreements with them on calling out, we have some restrictions on our ability to call customers, we had some restrictions on ability to contact customers that they have recently relaxed in the last few months. That has allowed us to call people more aggressively

And then lastly, we have had some support from GM GM has a program as to [one star] that has several millions, I can't give you the exact numbers, but several million subscribers that allows them to email out the status of the car, and they have put some enhancements to that program that allows us to help with conversions as well. So between this dealer incentive program, which is the one we are most excited about, the email program as well as the 80-day telephone call we can now make to everybody, we are anticipating that we should be able to make a difference. But all of these things are not being some causes to change our short-term expectations for conversion rate These are things that we are going to work out over time.

Joe Titlebaum

So in closing I would just like to say that the management team here, we are pleased with the quarter's results Obviously many of the things that we are talking about in terms of how we performed in retail or churns and other areas are not things that happen overnight We have been working on these things for a number of quarters They are starting to come into fruition We clearly will face other competitive challenges going forward, but we are very focused on managing the business to give good financial results at the end of the year, and we are very pleased with having surpassed 8 million subscribers, which I think is a great achievement and a tribute to the kind of product that we offer.

So with that we thank you very much for participating on the call, and we look forward to hearing from you in the future.

Operator

This concludes today's conference call You may now disconnect.

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