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Sirius Satellite Radio Q4 2006 Earnings Call Transcript

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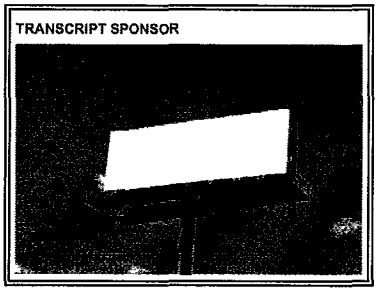

Sirius Satellite Radio Inc. (SIRI)
Q4 2006 Earnings Call
February 27, 2007 8:00 am ET

Executives

Paul Blalock - Senior Vice President, Investor Relations
Mel Karmazin - Chief Executive Officer, Director
James E. Meyer - President, Sales and Operations
Scott A. Greenstein - President, Entertainment and Sports
David J. Frear - Chief Financial Officer, Executive Vice President

Analysts

Ben Swinburne - Morgan Stanley
Robert Peck - Bear Stearns
Laraine Mancini - Merrill Lynch
Eileen Furukawa - Citigroup
Bryan Kraft - Credit Suisse
James Dix - Deutsche Bank
Barton Crockett - JP Morgan
David Bank - RBC Capital Markets

Presentation

Operator

Good day, everyone and welcome to the Sirius Satellite Radio fourth quarter and year-end 2006 earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Paul Blalock, Senior Vice President of Investor Relations. Mr. Blalock, please go ahead.

Paul Blalock

Thank you, Peter. Good morning, everyone, and thank you for your participation today. This morning, Mel Karmazin, our CEO, joined by Jim Meyer, President of Operations and Sales, and Scott Greenstein, President of Entertainment and Sports, will review our 2006 achievements and current outlook. David Frear, our Chief Financial Officer, will discuss our 2006 financial results and provide guidance for 2007. At the conclusion of our prepared remarks, management will take your questions

I would like to remind everyone that certain statements made during this call might be forward-looking as that term is defined in the Private Securities Litigation Reform Act of 1995. These and all forward-looking statements are based on management's current beliefs and expectations and necessarily dependent upon assumptions, data or methods that may be incorrect or imprecise. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. More information about those risks and uncertainties is contained in Sirius' SEC filings. We caution listeners not to rely unduly on forward-looking statements and disclaim any intent or obligation to update them.

I will now hand the call over to Mel for his opening remarks.

Mel Karmazin

Good morning, and thank you for joining us. 2006 was a banner year

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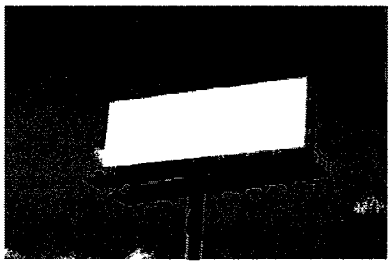

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for Sirius. For the full year, we added a record 2.7 million new subscribers, or 62% of the total satellite radio growth. In the fourth quarter, Sirius added 67% of total satellite radio net additions and in the retail segment, Sirius also represented 67% share. This is the strongest performance in the company's history and even stronger than the fourth quarter of 2005 and the first quarter of 2006, which is when Howard Stern first joined Sirius.

It is interesting to note that in the fourth quarter of 2006, Sirius also captured the majority -- 54% -- of gross subscriber additions for the first time in our history. Clearly our differentiated approach to programming has led to a differentiated brand and differentiated financial and operating results.

If you look back two years ago to the fourth quarter of 2004, our progress is even more apparent. Sirius added 481,000 subscribers in the fourth quarter of '04, for a 40% share of net add growth. In the fourth quarter of '06, Sirius added 905,000 subscribers for a 67% share of net add growth. This one-third/two-thirds split is a reversal of the trend just 24 months ago and a clear indication of a sustainable consumer preference for Sirius.

More importantly, Sirius achieved $30 million of positive free cash flow in the fourth quarter of 2006, achieving our stated goal of potentially reaching free cash flow positive as early as the fourth quarter. Although true GAAP earnings are years away, it is important to note that this is real cash flow and that includes the effect of capital expenditures.

For 2007, we expect total revenue to approach $1 billion. If we accomplish that goal, it will be the fastest to $1 billion in revenue in the history of radio.

Reviewing 2006, we expected $615 million in revenue and we delivered $637 million. Our average monthly revenue per user, or ARPU, was $11.01 in 2006, up from $10.34 I 2005. Our 2006 ARPU included a $0.56 contribution from net advertising revenue, an increase of 100% from the $0.28 net advertising revenue in 2005.

At the beginning of 2006, we expected to have more than 6 million subscribers at year-end, and we delivered on that original goal. Although strong growth in the first-half of the year caused us to revise upward our mid-year guidance, which was later reduced back to our original goal.

It is also interesting to note that in Canada, Sirius' fourth quarter MPD share was in excess of 70%. Last year, we also said that we expected to double our installed base of automotive customers during 2006. We started 2006 with 824,000 OEM subscribers and ended the year with more than 1.9 million, a 138% increase.

For the full year of 2006, Sirius achieved a 55% share of OEM net subscriber growth. We expected a 2006 customer churn rate of 1.8%. We delivered a churn rate which was 1.89%, and I am also pleased to report that our self-pay churn remained flat at 1.6% for the year, an industry-leading metric. We expected 2006 SAC per gross add to approach $110 and we delivered $114 for the full year and $103 for the fourth quarter. This is down from $139 SAC per gross add in 2005.

We expected the adjusted loss from operations EBITDA to be $565 million for the full year and we delivered $513 1 million, a 9% improvement and a clear indication of our cost-based focus

Looking forward into 2007, we expect revenue to approach $1 billion; subscribers to top 8 million; churn to average between 2.2% and 2.4%; and SAC per gross add to drop to approximately $95.

I believe that Sirius clearly delivered in 2006 and we are being very realistic about 2007. I will let Jim, Scott, and David take you through some more highlights in a moment, but I first want to make a few observations.

First, high levels of customer satisfaction coupled with the low levels of customer churn and increasing automotive penetration rates are great indicators of a positive long-term future for satellite radio and a solid place for our branded content in the new media world.

Second, Sirius is the premier destination to discover and experience audio entertainment, whether you are in your call or in your home, office, dorm room or on the Internet or in a WiFi enabled hotspot, Sirius' leadership in commercial-free music, premier sports and talk remains paramount to our success.

Third, as CEO and a large shareholder myself, I do not need to tell you that our stock performance has not matched our financial and operational success. I will remain steadfast in running this company to maximize our financial and market position and I am confident in our ability to deliver the best radio on radio.

Thank you for listening and we will be glad to handle your questions after we hear from the rest of the management team. Jim Meyer will now talk you through some of the operational details.

James E. Meyer

Thanks, Mel. 2006 was a very successful year for Sirius. Our initial 2006 goal of reaching parity in the marketplace was exceeded in each and every quarter of the year. Our goal for 2007 quite simply is to maintain our clear market leadership and as Mel mentioned, this is a dramatic reversal over the last two years.

In 2006, our product and distribution strategies were very successful. On the product side, we refurbished the product lineup with several new products, while reaching our cost reduction objectives and introducing some innovative firsts into the marketplace. We believe that the new products we have introduced make Sirius the produce lineup leader with the strongest offering in the industry, and you can expect more in 2007.

Sirius added 2.7 million net additions in 2006. That was comprised of approximately 1.1 million net additions from our auto partners and approximately 1.6 million retail net additions. Self-paid churn remained flat at 1.6% and total churn was 1.9% for the year.

In 2006, we made several investments aimed at our customer retention initiatives and we will continue to make additional investments in 2007, focused on retention initiatives.

Turning to the retail sector, the approximate 1.6 million retail net additions for 2006 represented a slight increase in retail net additions over 2005 and accounted for 55% of the 2006 satellite radio retail net addition share. In the fourth quarter 2006, our retail net add share rose to 65%, its highest level ever In addition, in the fourth quarter Sirius also captured 54% of gross subscriber additions.

Overall, I am very pleased with where we are in the after-market side of the business. Obviously our retail partners are aware of the strong consumer preference for Sirius. One particular success story for Sirius in 2006 was at Wal-mart where, as promised, we accomplished our goal of reaching parity in market share for the important fourth quarter. In addition, Sirius received the coveted Best Supplier of the Quarter Award for audio electronics from Wal-mart for the fourth quarter of 2006.

In 2007, in the after-market segment, we expect to maintain our market share position, including our market share leadership at Wal-mart for the full year.

Another key objective for 2007 is to continue to reduce our after-market SAC. This will be accomplished as we integrate our new generation four chips into our product lineup later this year. Not only will this effort significantly reduce the cost of our radios but the benefits will include a continued reduction in size and heat, leading to better, more innovative form factors as well as improvements in battery life.

The generation four chips are currently in production at ST Micro Electronics and we will begin to phase them in radios later this year.

On the technology front, I am also pleased to report that we are operating our hierarchal overlay modulation now for almost four months and you should expect us to launch new services in the first-half of this year. Stay tuned.

Now let's turn to the OEM world. In 2006, Sirius added 1.1 million OEM net additions, capturing 55% of the total OEM net addition share In the fourth quarter of 2006, Sirius added a record 349,000 OEM subscribers, which represents 65% of fourth quarter OEM net addition share, the highest results in our history. The 349,000 fourth quarter net OEM additions represent an improvement of 44% over our fourth quarter 2005 performance.

As Mel mentioned, our goal for 2006 was to double our OEM subscriber base and we more than accomplished that goal. Sirius started 2006 with 823,000 OEM subscribers and ended the year with over 1.9 million subscribers in this important channel. Factory programs continue to gain momentum. Sirius ended 2006 with 132 individual vehicle model factory programs and 149

total vehicle model programs.

OEM economics will continue to improve and our penetration rates continue to increase. The company's exclusive U.S. automotive OEM partners now number 21 individual automotive brands.

It is important to note the Chrysler Group is targeting a 40% overall penetration rate for the 2007 model year with Sirius factory programs. This is up from approximately 30% in the 2006 model year. Effective this month, the first Chrysler Group vehicles with Sirius real-time traffic are now hitting the dealer showrooms. This exciting new feature can be found in select vehicles that include a new MyGIG radios.

During the fourth quarter, the Chrysler Group launched a significant national media campaign which prominently featured Sirius in TV spots for Chrysler, Dodge, and Jeep vehicles. This national exposure was not only great for our brand but also had a very positive impact at the dealer level. Awareness of the Sirius option at the consumer and dealer levels has never been higher.

Ford is also coming on strong with Sirius now as a factory installed option in 22 vehicle lines, up from four models at the beginning of 2006. The Ford, Lincoln, and Mercury penetration rates for Sirius are all exceeding initial projections. Strong customer and dealer demand for the Sirius option is driving these increased penetration rates.

During the third quarter of 2006, Volkswagen and Audi began their 2007 model year launch of their previously announced exclusive partnership with Sirius. As previously mentioned, Volkswagen and Audi are targeting an 80% installation rate in their 2007 model year. This program is now fully operational and we are completely engaged with this important partner and their dealers.

Finally, Mercedes-Benz continues to install Sirius radios in now over two-thirds of all model year 2007 vehicles. Both deal and customer demand for Sirius in the Mercedes-Benz lineup is strong and improving.

In conclusion, I would like to make a few comments regarding consumer demand for Sirius satellite radio. As everyone knows, Howard's show debuted on Sirius in last year's first quarter and our subscriber growth benefited in a large way. As you see the MPD data come out for this year's first quarter, you should expect to see declines from last year's pace. January will be the steepest decline. From February forward, you should expect and we are seeing in February, continuous improvements as we work through last year's Howard bulge.

Another area for discussion is any consumer confusion caused by the pending merger We must not confuse consumers as we take the time necessary to work through the regulatory approvals required. To combat this issue, quite simply we will guarantee customers that any radio they buy from Sirius will not become obsolete. It is a simple but effective message to our customers and a very safe thing to do, given our long-term commitments to our OEM partners.

I would now like to turn it over to Scott.

Scott A. Greenstein

Thanks, Jim. In 2006, Sirius delivered on and solidified our position as the best radio on radio. To highlight the depth and diversity of our content on any given day and every day, I give you one example; leading associated press writer Larry McShane's story describing Sirius by paraphrasing renowned DJ Cousin Brucie as a new [inaudible] sums it up. McShane covered a day in the life of Sirius, a typical Tuesday, an article that was featured in print and online news outlets across the country with total circulation and viewership of over 38 million, detailing a day that featured Jamie Foxx announcing his exclusive urban comedy channel, T.G. Barber on NFL Radio, Howard Stern on the air, Martha Stewart doing her program on her channel, Senator Bill Bradley, along with highlights from the Catholic Channel, Candace Bushnell's radio show, OutQ, and of course other elements of Stern's programming.

If McShane had been here a couple of weeks later, he would have seen the Sinatra family announce their exclusive new channel on Sirius and last week, Barbara Walters talking to listeners on her live call-in Oscar show.

I will not spend much more time on the highlights of that day that McShane visited Sirius except to say that what made that day for him and what makes Sirius so special every day is that our priority, our mission and our promise to our talent and most importantly to our listeners is to have the best content go on the air. The old phrase content is king is still true in this technologically changing world today, and content is what makes Sirius the leader. It is what makes us the premier audio entertainment company.

Now let's talk about the biggest launch in radio since Howard Stern came to Sirius; Sirius NASCAR Radio. As everyone knows, NASCAR is the biggest spectator sport in America. If Daytona is any indication, NASCAR is every bit as huge as we thought it would be. Calls have jammed the lines every hour of the day since Sirius NASCAR radio launched its 24 hour service. A retail store close to Daytona sold out their entire Sirius stock by Saturday and race fans were approaching Sirius staff on site all weekend telling them what a difference Sirius NASCAR Radio has made to their race and fan experience.

Every one of the 37 racers in the NASCAR season will be an incredible promotional tool for us, locally activating each market on a grassroots level with the sheer power of what NASCAR describes as a virtual Super Bowl in 37 cities and selling Sirius NASCAR radio from Daytona and Talladega to Las Vegas and Phoenix.

We have also seen a tremendous response to the programming on Sirius NASCAR radio from the sports media. Much like our unrivaled football coverage on Sirius NFL radio, we are confident that Sirius NASCAR radio will continue to win over fans, pros, and press alike with unprecedented 24-7 coverage of every race and everything in between.

To sum up, USA Today in their Daytona coverage said: "For total immersion, the true diehard should also listen to Sirius satellite radio which will premier its NASCAR coverage with 10 channels that will be devoted solely to specific drivers, offering their in-car chatter non-stop throughout the race."

Like it has for us before, this kind of focus on premium programming results in remarkable positive press coverage, and as you have heard me say over and over again, press coverage serves Sirius both as publicity and cost-effective and organic marketing.

To illustrate the power of the point and the marketing dollars saved, in the whole of 2006, more than 13,000 print stories appeared with audience impressions of more than 25 billion in media outlets, including Forbes, Time Magazine, Los Angeles Times, Chicago Tribune, Washington Post, USA Today, and on and on and on, as well as being featured in broadcast segments on numerous network and cable programming, including the Today Show and Good Morning America.

Supported by our ongoing partner marketing with the likes of the NFL, Martha Stewart, Playboy, Cosmo, and the NBA, and the continued success of our best radio on radio campaign, we are confident that that press, coupled with our brand marketing and our partner marketing, we will remain not only the programming leader but the marketing leader as well. This is addition to the Daimler-Chrysler Mercury marketing campaigns that Jim referred to, as well as Radio Shack campaigns where Sirius and its programming were featured as the center of the marketing campaign in those particular instances, not just an add-on.

Advertisers continued to show they want to be where the best programming on radio is. That is no more apparent than on the new Sirius NASCAR radio channel, which just launched in January and saw advertising from the likes of Castrol and Home Depot.

In the coming months, look for the debut of new shows from publishing icon Jane Pratt, renowned pet expert Sonia Fitzpatrick, and the launch of exclusive channels, Seriously Sinatra and Jamie Foxx's Foxhole will all be on the air before the summer, and of course, more on NASCAR as the year progresses with the races.

We at Sirius remain committed to our listeners. We are confident that Sirius will continue to be the best radio on radio, and we look forward to another year of doing just that. Thank you and I will turn it over to David.

David J. Frear

Thanks, Scott. As in prior calls, my comments will follow the condensed operating statement in our press release, which excludes the effect of stock-based compensation expenses in the individual line items.

Sirius delivered a great fourth quarter and a great year, with a record 2.7 million net additions for the year in the company's first ever quarter of positive free cash flow. The 905,000 net subscribers added in the fourth quarter represents our fifth consecutive quarter of segment leadership in the metric that directly translates into our leading revenue growth.

Total fourth quarter revenue increased by 142%, or $113 million year over year to $193 million, as our subscriber base nearly doubled to over 6 million subs from just under 3.3 million a year ago. The nearly 3 million subs added in the last year have driven our annualized revenue run-rate to nearly $800 million today. This rapid growth has been accomplished with a high degree of efficiency as our focus on free cash flow has pushed us to drive and improve every key metric.

As Mel mentioned, SAC per gross add for the year improved 18% to $114 per gross add, and would have been lower but for costs associated with our FM modulator rework. The reduced fourth quarter SAC per gross add brought net cash invested per sub essentially to break-even levels. Our low in leading total churn, which includes self-pay churn as well as non-conversions of bundled subs, was 2% in the website and 1 9% for the year. This up-tick is attributable to the increase in our OEM subscriber base in our mix and the roll-off of non-converting bundled subscriptions.

Importantly, the self-paid component of our churn has remained very consistent with prior quarters, averaging 1.6% for the year and we do not see this changing in 2007. We do expect total churn to increase to a range of 2.2% to 2.4% in 2007, as we see the impact of a growing number of bundled subscriptions coming up for renewal.

Our results for 2006 also clearly showcase the scale inherent in our business model. Customer service and billing expenses per average subscriber declined 44% for the quarter to $1.49 per month and for the full year declined 41% to $1.24.

For 2006, total cost of service dropped from 76% of revenues to 59%, fully absorbing and then some the effect of adding Howard Stern to our lineup in 2006.

The balance of our operating expenses, engineering, design and development, G&A, and sales and marketing, were collectively cut in half as a percent of revenue in 2006 and we expect substantial continuing improvement in 2007.

Our adjusted loss from operations, or adjusted EBITDA, for the quarter improved by $59 million year over year to a loss of $167 million, better than street expectations. For the full year, adjusted loss from operations improved by $54 million to a loss of $513 million, beating out guidance for a loss of $565 million. The fourth quarter adjusted loss from operations represented a 26% improvement year over year, despite the additional fixed costs associated with our expanded and exclusive content. In 2007, we will continue to build on our already extraordinary content package with the addition of NASCAR, Jamie Foxx's Foxhole, Seriously Sinatra, and other new exciting content while maintaining tight spending discipline.

Adjusted EBITDA before SAC in marketing costs which the analyst community refers to as pre-marketing EBITDA, was positive $39 million for the quarter, or a 20% margin compared to a negative $18 million in Q405, or a negative 23% margin Similarly, for the full year we saw a $176 million improvement in pre-marketing EBITDA to positive $129 million.

For the fourth quarter, Sirius achieved its first ever quarter of positive free cash flow after capital expenditures, with free cash flow of $30 million compared to negative free cash flow of $63 million in the prior year period.

Sirius ended the quarter with approximately $409 million in cash, cash equivalents and marketable securities, up from approximately $352 million at the end of Q3.

In sum, 2006 was a milestone year for Sirius as we delivered on our business plan of achieving positive free cash flow, adding a record number of net new subscribers in a cost-effective manner and continuing to provide and enhance the best radio on radio. As disclosed in our press release, we are guiding to revenue approaching $1 billion on year-end subscribers of over 8 million and clarifying our expectation for SAC improvement and for churn.

Please note although our adjusted EBITDA loss and free cash flow will continue to improve substantially in 2007, we are not currently providing guidance on these measures in light of our pending merger with XM.

With that, let me turn it back to Mel.

Mel Karmazin

Thanks, David. Just before we take your questions, I would like to mention a few things that I am really excited about for 2007. First, exciting new products and services such as traffic, video and smaller radios with longer battery life and new features will continue to keep Sirius at the forefront of consumer interest and demand.

Second, as Scott mentioned, excellence in execution for both new and existing programming is paramount to our success. Getting the programming right is a constant activity so that everything from our music, talk and sports is continuously challenged and we are never finished. Every show, program and channel needs to be the best that it can possibly be within the financial goals that we have established. In particular, I am particularly excited about the new relationship with NASCAR and the impact that will have across our business. The introduction of the driver channels that Scott has mentioned could be very significant. In addition, the Catholic Channel, the Metropolitan Opera Channel, and the upcoming launch of Seriously Sinatra Channel, are all very exciting.

Sirius is particularly excited about the fact that it is successfully gaining penetration with 90% of the customers who currently do not purchase satellite radio but instead rely on terrestrial radio and other technology, many of which are available for free.

Finally, last week we announced the merger of equals with XM. We held a conference call and a replay of that call is available on our website for you to listen to. On Wednesday, we filed the merger agreement with the SEC as an 8-K and that is available on our website.

Additionally, we posted a Q&A on our website for answers to your frequently asked questions related to the merger and I would encourage you to read it.

Tomorrow, I will be in Washington to testify on the benefits of the merger and the greater consumer choice we believe the merger will generate. We believe that the combination of Sirius and XM is a win-win for consumers, partners, employees, and shareholders Over the coming months and years, we look forward to working with our counterparts at XM to achieve the significant benefits of this combination and execute on the many exciting opportunities this merger will create. I look forward to working with Gary Parsons and the entire team at XM and believe that together, we can offer consumers the very best radio on radio.

Let me end by saying that we are confident once regulators and government officials have a chance to understand our

business, our combined marketplace and what the combined company will offer consumers, especially in terms of choice, that they will see the benefits of this combination.

I am sure some of you may have some questions and we will be glad to address them if we can, so Operator, please open up for questions.

Question-and-Answer Session

Operator

(Operator Instructions)

We will take our first question from Ben Swinburne with Morgan Stanley.

Ben Swinburne - Morgan Stanley

If I could ask a retail question and an OEM question, on retail, Mel, does the guidance have a -- bake in some number for consumer confusion around the merger? I know you mentioned that in your prepared remarks and I am wondering if the 8 million plus number was adjusted downwards just to bake in some expectation that you will get less people walking in the store to buy radios because of the confusion over who is the surviving company

On the OEM side, I know you guys have less experience on this than XM, but any lessons learned you can share with us about how you at Sirius can either drive the conversion ratio higher or lower based on things you control, and how much of that is really just dictated by how the dealer performs and the OEM partner?

Mel Karmazin

I am going to ask -- I know you directed the question to me, but I think that Jim is better equipped to answer your specific questions, so I will let Jim handle it.

James E. Meyer

On the guidance for what we expect to do in 2007, I think it is fair to say that we have tempered the first-half of the year for what we believe are realistic expectations for retail demand in the after-market, and then we would expect both by getting by the Howard bubble as well as effectively communicating that there will not be an obsolescence issue with the pending merger, that we will see modest improvement in the second-half of the year. That is what is in our guidance and consistent with what we believe.

On the OEM side, we have learned a lot. I am afraid we have not learned as much as our counterparts have, but we are working very hard at it. Very clearly to me I think you hit on a key point, and that is it is very important to be -- we are learning more and more to be both integrated with let's call it the factory or a part of how the mother company goes to market with their merchandising and their campaign. I think we have made great progress there with both Chrysler and Ford, but as importantly, the dealer does play a very important role in retention rate in our understanding. First and foremost, just making sure the consumer knows he has the service, so we are very focused now. We have added a group in Detroit that is fully focused on working with the dealers and working with how we communicate with the dealers to improve our retention rates.

Mel Karmazin

I think the idea of the merger has certainly caused -- gotten satellite radio more front and center, so that part of it has been a positive. Again, I think our experience this past weekend was that we were not adversely affected from where we thought we would be because of the merger but it is understandable that there could be during this process some confusion. We will do our best to minimize that confusion, but that is possible. I still think that the idea of us adding about 2 million net subscribers this year is a pretty good growth rate for our company from where we are standing today.

Operator

We will take our next question from Robert Peck with Bear Stearns.

Robert Peck - Bear Stearns

Just a couple of quick questions here. First of all, Mel, in 2010, you had previously given out revenue and free cash flow guidance. I am wondering if you can reiterate that or update us.

David, I was wondering if you could -- I know you said you won't give '07 EBITDA or free cash flow guidance, but could you maybe talk about it directionally, particularly ex-merger costs, where you think that should be narrowing, and free cash flow, do

you think you will be free cash flow positive, et cetera?

Lastly, I am wondering if either of you can comment on the retail market share. Yesterday your competitor was out there saying that they think they can narrow your current market share and maybe you could talk about what is driving that and how you think you can defend it Thanks.

Mel Karmazin

On the first point about our long-term guidance that we had given, our comments that we have made, nothing has changed but for the merger. So you should assume that the only thing that has made us not be giving you any guidance has to do with the merger, not the fundamentals of our business.

On your last point, I have been hearing, we had originally said when we were on the short-end of the market share, that you should expect parity and from the time we exceeded parity, I have been hearing that they are going to gain market share. I get information every single week and the information that I get every single week still indicates Sirius has got the leading share at retail. I certainly understand that we have a good competitor in that area and that they are going to work on trying to increase their share but we are going to work hard, as Jim pointed out, on maintaining our lead at retail.

David J. Frear

I think as I said in my remarks, you should expected the adjusted EBITDA as well as free cash flow again, but for the merger, to improve substantially from what you have seen in '06, that the leverage in the business model now I think is very clear to everybody. The contribution margin, I know that we do not provide a variable paced P&L but the contribution margin remains right at about 70%, so we are enjoying the benefits of the leverage

As Mel said, the changes to our guidance are driven not by changes in our view of operations but simply by the considerations of the merger.

Mel Karmazin

Just so you know, when we were thinking about '07, if we did not announce the merger, we would have given you the same subscriber guidance.

Operator

We will go next to Laraine Mancini with Merrill Lynch.

Laraine Mancini - Merrill Lynch

When your competitor reported yesterday, they suggested that they thought retail would slow in '07. Could you comment on your view of the overall retail industry in '07? Second, there are a lot of rumors that GM and Chrysler might merge. How do you think that affects the space and the install rates?

Mel Karmazin

I will give you the second one. I do not know what is going to happen out there. We have a contract with Daimler-Chrysler. They are a very important partner. We are an important partner to them. Certainly we touched base with them since our merger and they were very enthusiastic for us and we will just wait and see what happens with them, but you should rest assured that we have a long-term contract with them and there is some very attractive economics for that contract to go on forever because of the fact that they receive, as we pointed out in the past, a revenue share for the life of the vehicle that if in fact we were not involved with them, they would have significant shortfalls from what they would expect to have received from us. But we are working closely with them, and as Jim pointed out, we are excited about their commitment to satellite radio.

James E. Meyer

On the retail side, I think a couple of things. One is this is not going to help much, but I will tell you the year is starting out through eight weeks exactly like we expected it to. It is a little scary how close it is tracking to exactly what we laid out. We knew we had to get by the Howard bubble. We learned that lesson in the fourth quarter of last year.

I fully expect, as I said in my comments, to see that variance versus last year improve on a monthly basis. I think in the middle of the year it gets back to flat, with maybe a tiny bit of growth. I don't know, and unfortunately we are going to have to wait again until the November and December timeframe because of the size of how much contribution that is to see what the overall year is going to look like in retail.

Personally, I believe we are going to end up with growth in the overall industry and I also believe that with effective

merchandising, we can get to that bigger bubble. There is still a tremendous amount of customers out there who do not have satellite radio and a big opportunity for us to get there and that is how we are going to merchandise and market for the remainder of the year.

Operator

(Operator Instructions)

We will go next to Eileen Furukawa, Citigroup.

Eileen Furukawa - Citigroup

Thanks for taking the question. I have a couple. Just a little update -- in your meetings with regulators over the last week, could you just give us an initial summary of the feedback and what their key concerns have been? Now also, what portion of your time do you expect will be spent in the coming months working on getting approval for the planned deal?

Then separately, could you give us a better idea of what the marketing spend you expect for next year, and do you expect an increase on a per gross add basis, given the increased spend you talk about for minimizing merger confusion?

Also, just in general what you think merger costs could be in 2007.

Mel Karmazin

We are certainly not prepared to speculate or to estimate what the merger costs are going to be, mainly because we are going to have to wait to hear from the Justice Department, as well as the FCC on what kind of information and what process we are going to be going through.

Regarding our conversations with regulators, they will be ongoing. We have met with each member of the FCC already. We have met in person with them along with Gary Parsons, so that we continue to give them information. The information is why this is in the public interest. We have made some I believe good arguments as to why it is in the public interest. I believe that when we file our application with Hart-Scott-Rodino we will lay out the competitiveness of the market and how this transaction is not anti-competitive.

When we file our application with the FCC, we will outline why this is very much in the public interest and if you take a look at if the merger does not happen, what is in it for the consumers versus if in fact it does happen, what is in it for the consumers, it is overwhelmingly a benefit of this merger for consumers and we think that is the public interest standard.

What amount of time I am going to spend on it -- I think the day expands based on how much you have to do, so I think David, Scott and Jim are going to be pleased that I will be distracted with some other things to do so I will not be bugging them quite as much as I have. They are well-equipped to handle their areas of responsibility and I could spend more time working with the regulators going forward. Hopefully this process will take somewhere in the six to nine months.

We believe at the end of the day and again, we are optimistic that we can get this merger approved.

Eileen Furukawa - Citigroup

Also, what kind of marketing spend you expect?

Mel Karmazin

I think that our marketing spend has not been adjusted for the merger. We believe that we have a good amount of money budgeted for advertising and marketing. If you take a look at our brand awareness, Scott had talked about it during his remarks, we have great brand awareness, so the American consumers know about the service and we have a lot of work to do because as I mentioned in my opening remarks, 90% of the consumers out there are not subscribing to satellite radio, so if you were to take the number of subscribers we have and adjust it for multiple receivers and adjust it for people who own both, you get to about 10 million subscribers.

We know that there are 250 million cars on the road today. We know there are 109 million homes. We know that there are about 300 million people and we have 10 million subscribers, so we have done a really good job over the last five years, but there is a very long way to go and we think that we have budgeted in the guidance we have given you the correct amount of money for advertising, although Scott will tell you that you never have enough money in advertising

Operator

We go next to Bryan Kraft, Credit Suisse.

Bryan Kraft - Credit Suisse

Thank you. I just have two quick ones. What percentage of your base is now family plans subscriptions and how are you thinking about the segment going forward? Then also, could you just talk about what your expectations are for self-pay SAC per gross add that is embedded in your SAC guidance?

David J. Frear

The multi-subscription plans, they are in the 13% to 14% range and we do expect them to increase as we continue to market into our subscriber base.

Self-pay churn rates, I think as we said before, we expect to remain largely consistent. What we have seen over the last couple of years, there has not been a whole lot of variation to them. They do show some seasonality, that they tend to be a little bit higher coming off the back of the Christmas season. They tend to be a little bit higher in July coming off the back of Father's Day selling. But over the course of the year, they have been very consistent in this 1.6% range.

Operator

We will go next to James Dix, Deutsche Bank.

James Dix - Deutsche Bank

Good morning, gentlemen. Just a couple of questions. I wanted to know whether you had any estimate as to what proportion of the adult population has actually heard satellite radio, whether you have any survey data on that. Then, have you done any work to try to break down why people churn, other than simple non-payment?

I guess my last question would be, do you have any assessment as to what you think the longer-term impact might be on the OEM channel from the efforts of the auto-makers to facilitate the use of nomadic devices in cars, like iPods, MP3 players, Smartphones. I'm thinking for example of Ford's program to install the sync system starting with the next model year. Thanks.

Mel Karmazin

On your first question, no, we really do not have any data that will tell us what percentage of the people have listened to satellite radio. We know the number of listeners that we have to our service. We know that we did a free sampling on the Internet, where you can listen to our content for a weekend, and that got some great reaction. But I do not have any hard data.

Regarding all of the other items that the car companies have had in their cars, we certainly look at all of these audio options as competitive to satellite radio and certainly the idea of an iPod ability to be in your car and someone is going to potentially listen to that as compared to satellite radio is a competitor. Having said that, I believe that there has always been a competitor and lots of competitors for the car for radio and in addition, for us competing with terrestrial and radio, all of the radio industry faces competition from CD players, and when cell phones first came into the car.

So yes, from one point of view, there is a great deal of competition and it is sort of clearly explains our viewpoint on the merger, that there is so much competition. On the other hand, we have been focused on our own content, and Scott goes through each quarter painstakingly the investment that we have made in content and we believe that our content is superior to any other choice that you would have in this competitive area.

So from our point of view, we think that Sirius will be the big winner when it comes time for having the best radio on radio.

There was a middle question that I am not sure I got.

James Dix - Deutsche Bank

Just any data you had on why people churn, other than simple non-payment, any surveys on that?

David J. Frear

Non-payment is far and away the biggest source of churn, and then it drops dramatically from there to some general categories that go with some kind of dissatisfaction, whether it is with equipment or reception or programming. We generally find that if you are going to churn for a dissatisfied reason, it tends to -- it is almost like an infant mortality thing. It happens in the first 60, 90 days of service And then you get to receiver-related and vehicle-related things, which are kind of like the turnover of homes in the cable industry, where somebody's receiver is lost, stolen or destroyed, or they sell their car or their car is stolen or gets in a wreck.

Those are the principal components.

Mel Karmazin

I think that 1.65 or thereabouts in self-pay churn is pretty good, particularly when you look across other subscription businesses, and that is really what we measure for the satisfaction of our service, as compared to something that we have which most other subscription businesses do not have, which is the OEM conversion aspect of the business. So that 1.65 we think is pretty good churn that we continue to work on to try to improve even more.

Operator

We will go next to Barton Crockett, JP Morgan.

Barton Crockett - JP Morgan

I really wanted to ask about two things. One, if you could just tell us, give us a clearer, more precise update on your expectations for OEM conversion from the promotional periods. I know in the past you have said generally over time it should trend like XM. I think you have also had some verbiage that you are maybe a little bit greener at working on the promotional conversions than XM I am just wondering if that suggests maybe if you think it might start at a little bit below where XM is right now and then trend up over time as you get better. That would be the -- get more experience at this.

The second question then would be, turning to the merger side, can you tell us specifically if your contracts with Howard Stern or with the NFL, your two most high profile content deals, I guess I would also throw Martha in there and NASCAR, if those give you the right to put that content on XM if you were to complete a merger as the contracts are currently stipulated, or whether you would have to go back in and adjust those contracts? Give us some sense of how significant you think that adjustment process might be. Thank you.

Mel Karmazin

On the second point, we are not going to comment on any of the details in any of our specific contracts. We have said that we believe that the synergies that are available to shareholders as a result of this merger are very significant. We have affirmed the range that generally Wall Street has estimated for the benefits of the merger and you should work with that number and assume that if in fact there are any that would require any adjustment, that it would be reflected in that overall synergy.

Again, let me turn it over to David on the first part of the question.

David J. Frear

On the conversion rates, I think we are going to stick with talking to about our business in the way that we have been for the last couple of years. We have been providing you guys guidance on the aggregation of our different distribution channels. As we have looked at this and considered it over the course of the past year, we think it is the best way to continue to do it. So obviously the OEM conversion rate is embedded within the total churn that we have consistently reported for the last couple of years.

We get there for a couple of reasons. Our go-to-market model with our OEM partners is significantly different than our competitor's. We have a big distribution partner who bundles in 12-month subscriptions. We have another big distribution partner who uses six months. We have got guys coming online in the course of the next year or so that will be at three months.

So as we look at the conversion rate, we do not know what we would ask you to apply it to, that we do not have a bundled sub category that rolls up for renewal at a predictable and consistent pace the way that our competitor has, who has a very -- the dominant portion of their volume goes out with this three-month promotional period.

I just think that there is a lot less utility in it for guidance purposes, so we are going to stick with total churn.

Operator

We will go next to David Bank, RBC Capital Markets.

David Bank - RBC Capital Markets

Just a quick one -- actually, two quick ones. The first one was, I appreciate the increasing depth of information that you guys are giving. I was wondering if I could go one step further and get gross adds by channel.

The second question is Mel, in terms of the regulatory process here, have you ever encountered -- you have done a lot of transactions. Have you ever encountered something close to this in terms of what you feel like you have to surmount to get the deal done?

David J. Frear

On the gross adds by channel, again I think we are going to stick with the rule that we have been using for guidance going forward, that the gross adds by channel, if we are not going to pair it with SAC by channel, if we are not going to pair it with churn by channel, then it is kind of like an island of information.

I think we will just continue to report gross adds in total

Mel Karmazin

On the regulatory side, I have done a few of these deals and it seems that all of them have gotten the attention of regulators and congress. I remember when we did a transaction that involved the Philadelphia radio stations and somebody said "well, you will have two country music stations and you are going to own the country market".

If you think back to the Westinghouse-CBS merger, when there was two all-news radio stations, WINS was Westinghouse and WCBS Radio was CBS, and there were questions that were raised about the combination and owning the all-news radio market in New York City.

The deal involving Infinity and CBS obviously prompted some congressional hearings and we went through the process, both with Hart-Scott-Rodino and the Justice Department and the FCC, and at the end of the day, they concluded that it was correct.

We did an $80 billion merger between CBS and Viacom that caused a great deal of attention and we had a number of hearings. We went through the FCC and the Justice Department and felt that was in the public's best interest.

If you think about this one, you have as I mentioned, there is 10% of the population that has satellite radio that even the people who have satellite radio have an AM/FM radio alongside it. We also in every one of these situations, the idea of having all of these choices available to the consumer are obviously plentiful, and though I do not like to highlight this, you have seen our losses this year and you saw what XM's losses this year are. So you are really dealing with companies that are losing $1.5 billion on an EBITDA basis and even on a real free cash flow basis, losing hundreds and hundreds of millions of dollars.

Again, we are going to have to make the arguments to the regulators that this merger is not anti-competitive, which it is not. We are going to make the argument that it is in the consumers' best interest, which it is and we are going to hopefully prevail. If not, we are going to do our best to try to prevail.

Operator

This does conclude today's question-and-answer session. At this time, I would like to turn the call back over to Mel for any additional or closing remarks.

Mel Karmazin

Thank you for joining us today and have a good quarter

Operator

This does conclude today's conference. Thank you for your participation.

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