
SIRIUS XM RADIO INC.

(Exact name of company as specified in its charter)

QUARTERLY REPORT

For the Quarterly Period Ended September 30, 2016

Explanatory Note

Sirius XM Radio Inc. (“Sirius XM”) is furnishing this Quarterly Report for the quarterly period ended September 30, 2016 (the “Quarterly Report”) in order to comply with the reporting obligations in the indentures governing its 4.25% Senior Notes due 2020, 5.75% Senior Notes due 2021, 5.25% Senior Secured Notes due 2022, 4.625% Senior Notes due 2023, 6.00% Senior Notes due 2024, 5.375% Senior Notes due 2025 and 5.375% Senior Notes due 2026 (collectively, the “Notes”).

Before making any investment decisions in Sirius XM or Sirius XM Holdings Inc. (“Holdings”), investors should read the following consolidated financial statements and Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) of Sirius XM in conjunction with Holdings’ Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016 and Holdings’ other reports available through the Securities and Exchange Commission website at www.sec.gov and our website at www.siriusxm.com, and with Sirius XM’s other reports available through our website. Holdings’ Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016 is hereby incorporated by reference. Sirius XM is a wholly-owned subsidiary of Holdings and Holdings has no operations independent of Sirius XM. Refer to Note 1 to the unaudited consolidated financial statements included within this Quarterly Report for an explanation of differences between Sirius XM and Holdings’ unaudited consolidated financial statements.

The terms “Sirius XM,” “we,” “us,” “our,” and the “Company,” as used herein and unless otherwise stated or indicated by context, refer to Sirius XM Radio Inc. and its subsidiaries.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
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SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

<i>(in thousands)</i>	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Subscriber revenue	\$ 1,069,746	\$ 974,471	\$ 3,112,712	\$ 2,826,018
Advertising revenue	34,268	33,131	99,330	88,843
Equipment revenue	31,306	25,875	86,285	79,979
Other revenue	142,326	136,235	415,895	379,072
Total revenue	1,277,646	1,169,712	3,714,222	3,373,912
Operating expenses:				
Cost of services:				
Revenue share and royalties	272,823	238,620	788,952	783,115
Programming and content	89,015	75,707	257,760	216,223
Customer service and billing	94,923	94,492	285,502	278,521
Satellite and transmission	22,224	22,743	80,609	65,761
Cost of equipment	9,674	9,246	29,181	29,021
Subscriber acquisition costs	120,111	133,009	381,516	391,773
Sales and marketing	99,194	90,541	279,278	255,778
Engineering, design and development	19,254	16,132	57,588	47,180
General and administrative	90,369	67,234	249,052	219,194
Depreciation and amortization	67,880	70,404	202,215	202,527
Total operating expenses	885,467	818,128	2,611,653	2,489,093
Income from operations	392,179	351,584	1,102,569	884,819
Other income (expense):				
Interest expense	(89,092)	(76,624)	(250,888)	(221,912)
Other income	2,370	4,133	15,733	9,077
Total other expense	(86,722)	(72,491)	(235,155)	(212,835)
Income before income taxes	305,457	279,093	867,414	671,984
Income tax expense	(111,556)	(112,543)	(326,108)	(296,893)
Net income attributable to Sirius XM Radio Inc.'s sole stockholder	\$ 193,901	\$ 166,550	\$ 541,306	\$ 375,091
Foreign currency translation adjustment, net of tax	(14)	(91)	420	(100)
Total comprehensive income attributable to Sirius XM Radio Inc.'s sole stockholder	\$ 193,887	\$ 166,459	\$ 541,726	\$ 374,991

See accompanying notes to the unaudited consolidated financial statements.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2016	December 31, 2015
ASSETS	(unaudited)	
Current assets:		
Cash and cash equivalents	\$ 572,382	\$ 111,838
Receivables, net	233,419	234,782
Inventory, net	28,030	22,295
Related party current assets	5,249	5,941
Prepaid expenses and other current assets	202,289	187,033
Total current assets	1,041,369	561,889
Property and equipment, net	1,381,114	1,415,401
Intangible assets, net	2,556,568	2,593,346
Goodwill	2,205,107	2,205,107
Related party long-term assets	4,696,984	3,522,162
Deferred tax assets	1,101,014	1,115,731
Other long-term assets	131,492	155,188
Total assets	<u>\$ 13,113,648</u>	<u>\$ 11,568,824</u>
LIABILITIES AND STOCKHOLDER EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 613,613	\$ 625,313
Accrued interest	108,370	91,655
Current portion of deferred revenue	1,811,283	1,771,915
Current maturities of long-term debt	358,701	4,764
Related party current liabilities	3,015	2,840
Total current liabilities	2,894,982	2,496,487
Deferred revenue	170,662	157,609
Long-term debt	5,743,389	5,443,614
Related party long-term liabilities	8,665	10,795
Deferred tax liabilities	6,681	6,681
Other long-term liabilities	97,976	97,967
Total liabilities	8,922,355	8,213,153
Commitments and contingencies (Note 12)		
Stockholder equity:		
Common stock, par value \$0.001; 9,000,000 shares authorized; 1 share issued and outstanding at September 30, 2016 and December 31, 2015, respectively	—	—
Accumulated other comprehensive loss, net of tax	(82)	(502)
Additional paid-in capital	8,679,538	8,679,538
Accumulated deficit	(4,488,163)	(5,323,365)
Total stockholder equity	4,191,293	3,355,671
Total liabilities and stockholder equity	<u>\$ 13,113,648</u>	<u>\$ 11,568,824</u>

See accompanying notes to the unaudited consolidated financial statements.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
CONSOLIDATED STATEMENT OF STOCKHOLDER EQUITY
(UNAUDITED)

<i>(in thousands)</i>	Common Stock		Accumulated Other Comprehensive (Loss) Income	Additional Paid-in Capital	Accumulated Deficit	Total Stockholder Equity
	Shares	Amount				
Balance at December 31, 2015	1	\$ —	\$ (502)	\$ 8,679,538	\$ (5,323,365)	\$ 3,355,671
Cumulative effect of change in accounting principle	—	—	—	—	293,896	293,896
Comprehensive income, net of tax	—	—	420	—	541,306	541,726
Balance at September 30, 2016	1	\$ —	\$ (82)	\$ 8,679,538	\$ (4,488,163)	\$ 4,191,293

See accompanying notes to the unaudited consolidated financial statements.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

<i>(in thousands)</i>	For the Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$ 541,306	\$ 375,091
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	202,215	202,527
Non-cash interest expense, net of amortization of premium	6,571	5,851
Provision for doubtful accounts	39,629	34,031
Amortization of deferred income related to equity method investment	(2,082)	(2,082)
Gain on unconsolidated entity investments, net	(9,725)	—
Dividend received from unconsolidated entity investment	7,160	11,260
Loss on disposal of assets	12,912	—
Share-based payment expense	77,890	62,334
Deferred income taxes	308,613	285,478
Other non-cash purchase price adjustments	—	(1,394)
Changes in operating assets and liabilities:		
Receivables	(38,266)	(50,651)
Inventory	(5,735)	(7,346)
Related party, net	(23,636)	(52,542)
Prepaid expenses and other current assets	(15,985)	(70,758)
Other long-term assets	26,668	(51,842)
Accounts payable and accrued expenses	(12,833)	25,743
Accrued interest	16,715	14,923
Deferred revenue	52,421	81,626
Other long-term liabilities	11	(658)
Net cash provided by operating activities	1,183,849	861,591
Cash flows from investing activities:		
Additions to property and equipment	(132,246)	(90,943)
Purchases of restricted and other investments	(4,168)	(3,966)
Net cash used in investing activities	(136,414)	(94,909)
Cash flows from financing activities:		
Intercompany financing activities	(1,225,284)	(1,647,728)
Proceeds from long-term borrowings and revolving credit facility, net of costs	1,387,257	1,579,323
Repayment of long-term borrowings and revolving credit facility	(748,864)	(693,456)
Net cash used in financing activities	(586,891)	(761,861)
Net increase in cash and cash equivalents	460,544	4,821
Cash and cash equivalents at beginning of period	111,838	147,724
Cash and cash equivalents at end of period	\$ 572,382	\$ 152,545

See accompanying notes to the unaudited consolidated financial statements.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued
(UNAUDITED)

<i>(in thousands)</i>	For the Nine Months Ended September 30,	
	2016	2015
Supplemental Disclosure of Cash and Non-Cash Flow Information		
Cash paid during the period for:		
Interest, net of amounts capitalized	\$ 222,110	\$ 192,927
Income taxes paid	\$ 15,857	\$ 8,163
Non-cash investing and financing activities:		
Capital lease obligations incurred to acquire assets	\$ 6,647	\$ 7,487

See accompanying notes to the unaudited consolidated financial statements.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

(1) Business & Basis of Presentation

Business

We transmit music, sports, entertainment, comedy, talk, news, traffic and weather channels, as well as infotainment services, in the United States on a subscription fee basis through our two proprietary satellite radio systems. Subscribers can also receive music and other channels, plus features such as SiriusXM On Demand and MySXM, over our Internet radio service, including through applications for mobile devices. We are also a leader in providing connected vehicle services. Our connected vehicle services are designed to enhance the safety, security and driving experience for vehicle operators while providing marketing and operational benefits to automakers and their dealers.

We have agreements with every major automaker (“OEMs”) to offer satellite radio in their vehicles. We also acquire subscribers through marketing to owners and lessees of previously owned vehicles that include factory-installed satellite radios that are not currently subscribing to our services. Additionally, we distribute our satellite radios through retailers online and at locations nationwide and through our website. Satellite radio services are also offered to customers of certain rental car companies.

Our primary source of revenue is subscription fees, with most of our customers subscribing on an annual, semi-annual, quarterly or monthly plan. We offer discounts for prepaid, longer term subscription plans, as well as a multiple subscription discount. We also derive revenue from activation and other fees, the sale of advertising on select non-music channels, the direct sale of satellite radios and accessories, and other ancillary services, such as our weather, traffic and data services.

In certain cases, a subscription to our radio services is included in the sale or lease price of new or previously owned vehicles. The length of these subscriptions varies but is typically three to twelve months. We receive payments for these subscriptions from certain automakers. We also reimburse various automakers for certain costs associated with satellite radios installed in new vehicles.

As of September 30, 2016, Liberty Media Corporation (“Liberty Media”) beneficially owned, directly and indirectly, approximately 65% of the outstanding shares of Holdings' common stock. As a result, Holdings is a “controlled company” for the purposes of the NASDAQ corporate governance requirements. Liberty Media owns interests in a range of media, communications and entertainment businesses.

Recent Development

Recapitalization of Sirius XM Canada

On May 12, 2016, we entered into an arrangement agreement (the “Arrangement Agreement”) with Sirius XM Canada Holdings Inc. (“Sirius XM Canada”), an entity in which we currently hold an approximate 37% economic interest and 25% voting interest. Pursuant to the Arrangement Agreement, the Company and certain Canadian shareholders will form a new company to acquire shares of Sirius XM Canada not already owned by us and certain Canadian shareholders pursuant to a plan of arrangement (the “Transaction”). In connection with the Transaction, Sirius XM Canada’s shareholders will be entitled to elect to receive, for each share of Sirius XM Canada held, C\$4.50 (U.S. \$3.50 as of May 12, 2016) in (i) cash, (ii) shares of Holdings' common stock, (iii) a security exchangeable for shares of Holdings' common stock, or (iv) a combination thereof; provided that no more than 50% of the total consideration in the Transaction (or up to 35,000 shares) will be issued in Holdings' common stock and exchangeable shares. All of the obligations under the Arrangement Agreement are guaranteed by us.

Following the Transaction, we are expected to hold a 70% economic interest and 33% voting interest in Sirius XM Canada, with the remainder of the voting power and economic interest held by Slight Communications and Obelysk Media, two of Sirius XM Canada’s current Canadian shareholders. We expect to contribute to Sirius XM Canada approximately U.S. \$275,000 in connection with the Transaction (assuming that all shareholders elect to receive cash in connection with the Transaction), which amount is expected to be used to pay the cash consideration to Sirius XM Canada’s shareholders and will be decreased proportionately if shareholders elect to receive consideration in shares of Holdings' common stock or securities exchangeable for Holdings' common stock.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

The Transaction has been approved by the stockholders of Sirius XM Canada and has received the required court approval. The Transaction remains subject to receipt of Canadian Radio-Television and Telecommunications Commission approval. Pending receipt of this approval, the Transaction is expected to close in the fourth quarter of 2016.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Certain information and footnote disclosures normally included in the financial statements presented in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

The unaudited consolidated financial statements for Sirius XM for the quarterly period ended September 30, 2016 are essentially identical to the unaudited consolidated financial statements included in Holdings' Form 10-Q for the quarterly period ended September 30, 2016, filed with the SEC on October 27, 2016, with the following exceptions:

- As a result of our corporate reorganization effective November 15, 2013, all of the outstanding shares of Sirius XM's common stock were converted, on a share for share basis, into identical shares of common stock of Holdings and all equity-related transactions, including repurchases of Holdings' common stock and the issuance of equity related to stock-based compensation to Sirius XM employees, Holdings' directors and third parties have been reported as related party transactions within Sirius XM's unaudited consolidated financial statements. Refer to Note 8 for additional information related to related party transactions.

Certain numbers in our prior period consolidated financial statements have been reclassified to conform to our current period presentation. All significant intercompany transactions have been eliminated in consolidation. In the opinion of our management, all normal recurring adjustments necessary for a fair presentation of our unaudited consolidated financial statements as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 have been made. Interim results are not necessarily indicative of the results that may be expected for a full year. This Quarterly Report should be read together with our Annual Report for the year ended December 31, 2015, which is available on our website at <http://investor.siriusxm.com/investor-overview/default.aspx#dividend-tab2>, and with Holdings' Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the SEC on February 2, 2016.

Public companies, including our parent Holdings, are required to disclose certain information about their reportable operating segments. Operating segments are defined as significant components of an enterprise for which separate financial information is available and is evaluated on a regular basis by the chief operating decision makers in deciding how to allocate resources to an individual segment and in assessing performance of the segment. We have determined that we have one reportable segment as our chief operating decision maker, our Chief Executive Officer, assesses performance and allocates resources based on the consolidated results of operations of our business.

We have evaluated events subsequent to the balance sheet date and prior to the furnishing of this Quarterly Report for the three and nine months ended September 30, 2016 and have determined that no events have occurred that would require adjustment to our unaudited consolidated financial statements. For a discussion of subsequent events that do not require adjustment to our unaudited consolidated financial statements refer to Note 14.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes. Estimates, by their nature, are based on judgment and available information. Actual results could differ materially from those estimates. Significant estimates inherent in the preparation of the accompanying unaudited consolidated financial statements include asset impairment, depreciable lives of our satellites, share-based payment expense, and income taxes.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

(2) Summary of Significant Accounting Policies

Fair Value Measurements

For assets and liabilities required to be reported at fair value, GAAP provides a hierarchy that prioritizes inputs to valuation techniques used to measure fair value into three broad levels. Level 1 inputs are based on unadjusted quoted prices in active markets for identical instruments. Level 2 inputs are inputs, other than quoted market prices included within Level 1, that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. As of September 30, 2016 and December 31, 2015, the carrying amounts of cash and cash equivalents, receivables, and accounts payable approximated fair value due to the short-term nature of these instruments.

Our assets and liabilities measured at fair value were as follows:

	September 30, 2016				December 31, 2015			
	Level 1	Level 2	Level 3	Total Fair Value	Level 1	Level 2	Level 3	Total Fair Value
Assets:								
Sirius XM Canada Holdings Inc. ("Sirius XM Canada") - investment ^(a)	\$171,297	—	—	\$ 171,297	\$141,850	—	—	\$ 141,850
Liabilities:								
Debt ^(b)	—	\$6,422,566	—	\$6,422,566	—	\$5,649,173	—	\$5,649,173

- (a) This amount approximates fair value. The carrying value of our investment in Sirius XM Canada was \$5,853 and \$0 as of September 30, 2016 and December 31, 2015, respectively.
- (b) The fair value for non-publicly traded instruments is based upon estimates from a market maker and brokerage firm. Refer to Note 9 for information related to the carrying value of our debt as of September 30, 2016 and December 31, 2015.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The areas for simplification in this ASU involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, forfeiture calculations, and classification on the statement of cash flows. The amendments in this ASU are effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years, and early adoption is permitted. An entity that elects early adoption must adopt all of the amendments in the same period.

We elected to early adopt ASU 2016-09 in the third quarter of 2016, which required that any adjustments be reflected as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption of ASU 2016-09 was the recognition of excess tax benefits in our provision for income taxes of \$1,101 and \$1,950 for the three months ended March 31, 2016 and June 30, 2016, respectively. The adoption of this ASU impacted our previously reported quarterly results during fiscal year 2016 as follows:

	For the Three Months Ended				For the Six Months Ended	
	March 31, 2016		June 30, 2016		June 30, 2016	
Income statements:	As reported	As adjusted	As reported	As adjusted	As reported	As adjusted
Income tax expense	\$ (109,343)	\$ (108,242)	\$ (108,260)	\$ (106,310)	\$ (217,603)	\$ (214,552)
Net income	\$ 171,339	\$ 172,440	\$ 173,015	\$ 174,965	\$ 344,354	\$ 347,405

Additionally, we recognized net operating losses related to excess share-based compensation tax return deductions that were previously tracked off balance sheet but not recorded in our financial statements. As of January 1, 2016, the cumulative effect in the amount of \$293,896, net of a \$1,946 reserve for an uncertain tax position, was recorded as an increase to our Deferred tax assets and decrease to our Accumulated deficit in our unaudited consolidated balance sheets as a result of this cumulative effect of change in accounting principle.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

Additional amendments to this ASU related to income taxes and minimum statutory withholding tax requirements had no impact to accumulated deficit, where the cumulative effect of these changes are required to be recorded. Further, there was no impact to our classification of awards as either equity or liabilities. We also elected to true-up forfeitures in the period of adoption and in the future will recognize forfeitures as they occur.

This ASU also required excess tax benefits to be separated from other income tax cash flows and classified as an operating activity, however there was no impact to the consolidated statement of cash flows as we have not had any excess tax benefits (windfalls) recorded for book purposes. The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to any of the periods presented in our consolidated statement of cash flows as such cash flows have historically been presented as a financing activity.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires a company to recognize lease assets and liabilities arising from operating leases in the statement of financial position. This ASU does not significantly change the previous lease guidance for how a lessee should recognize the recognition, measurement, and presentation of expenses and cash flows arising from a lease. Additionally, the criteria for classifying a finance lease versus an operating lease are substantially the same as the previous guidance. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and early adoption is permitted. This ASU must be adopted using a modified retrospective approach. We plan to adopt this ASU on January 1, 2019. We are currently evaluating the impact of the adoption of this ASU on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. This ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued ASU 2015-14 which amended the effective date of this ASU to fiscal years beginning after December 15, 2017, and early adoption is permitted only for fiscal years beginning after December 15, 2016. We plan to adopt this ASU on January 1, 2018. In 2016, the FASB issued additional guidance which clarified principal versus agent considerations, identification of performance obligations and the implementation guidance for licensing. In addition, the FASB issued guidance regarding practical expedients related to disclosures of remaining performance obligations, as well as other amendments to guidance on transition, collectibility, non-cash consideration and the presentation of sales and other similar taxes. Companies may use either a full retrospective or a modified retrospective approach to adopt this ASU. We are currently evaluating the impact of the adoption of this ASU on our consolidated financial statements.

(3) Receivables, net

Receivables, net, includes customer accounts receivable, receivables from distributors and other receivables.

Customer accounts receivable, net, includes receivables from our subscribers and advertising customers and is stated at amounts due, net of an allowance for doubtful accounts. Our allowance for doubtful accounts is based upon our assessment of various factors. We consider historical experience, the age of the receivable balances, current economic conditions and other factors that may affect the counterparty's ability to pay. Bad debt expense is included in Customer service and billing expense in our unaudited consolidated statements of comprehensive income.

Receivables from distributors primarily include billed and unbilled amounts due from OEMs for services included in the sale or lease price of vehicles, as well as billed amounts due from wholesale distributors of our satellite radios. Other receivables primarily include amounts due from manufacturers of our radios, modules and chipsets where we are entitled to subsidies and royalties based on the number of units produced. We have not established an allowance for doubtful accounts for our receivables from distributors or other receivables as we have historically not experienced any significant collection issues with OEMs or other third parties.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

Receivables, net, consists of the following:

	<u>September 30, 2016</u>	<u>December 31, 2015</u>
Gross customer accounts receivable	\$ 108,110	\$ 98,740
Allowance for doubtful accounts	(7,443)	(6,118)
Customer accounts receivable, net	\$ 100,667	\$ 92,622
Receivables from distributors	107,172	120,012
Other receivables	25,580	22,148
Total receivables, net	<u>\$ 233,419</u>	<u>\$ 234,782</u>

(4) Inventory, net

Inventory consists of finished goods, refurbished goods, chipsets and other raw material components used in manufacturing radios. Inventory is stated at the lower of cost or market. We record an estimated allowance for inventory that is considered slow moving or obsolete or whose carrying value is in excess of net realizable value. The provision related to products purchased for resale in our direct to consumer distribution channel and components held for resale by us is reported as a component of Cost of equipment in our unaudited consolidated statements of comprehensive income. The provision related to inventory consumed in our OEM and retail distribution channel is reported as a component of Subscriber acquisition costs in our unaudited consolidated statements of comprehensive income.

Inventory, net, consists of the following:

	<u>September 30, 2016</u>	<u>December 31, 2015</u>
Raw materials	\$ 11,618	\$ 11,085
Finished goods	25,937	21,159
Allowance for obsolescence	(9,525)	(9,949)
Total inventory, net	<u>\$ 28,030</u>	<u>\$ 22,295</u>

(5) Goodwill

Goodwill represents the excess of the purchase price over the estimated fair value of the net tangible and identifiable intangible assets acquired in business combinations. Our annual impairment assessment of our single reporting unit is performed as of the fourth quarter of each year, and an assessment is performed at other times if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized.

As of September 30, 2016, there were no indicators of impairment, and no impairment loss was recorded for goodwill during the three and nine months ended September 30, 2016 and 2015. As of September 30, 2016, the cumulative balance of goodwill impairments recorded since the July 2008 merger (the "Merger") between our wholly owned subsidiary, Vernon Merger Corporation, and XM Satellite Radio Holdings Inc. ("XM"), was \$4,766,190, which was recognized during the year ended December 31, 2008.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

(6) Intangible Assets

Our intangible assets include the following:

	Weighted Average Useful Lives	September 30, 2016			December 31, 2015		
		Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Indefinite life intangible assets:							
FCC licenses	Indefinite	\$ 2,083,654	\$ —	\$ 2,083,654	\$ 2,083,654	\$ —	\$ 2,083,654
Trademark	Indefinite	250,000	—	250,000	250,000	—	250,000
Definite life intangible assets:							
Subscriber relationships	9 years	380,000	(358,140)	21,860	380,000	(336,822)	43,178
OEM relationships	15 years	220,000	(42,778)	177,222	220,000	(31,778)	188,222
Licensing agreements	12 years	45,289	(29,741)	15,548	45,289	(26,977)	18,312
Proprietary software	8 years	27,215	(19,298)	7,917	27,215	(17,752)	9,463
Developed technology	10 years	2,000	(1,633)	367	2,000	(1,483)	517
Leasehold interests	7.4 years	—	—	—	132	(132)	—
Total intangible assets		<u>\$ 3,008,158</u>	<u>\$ (451,590)</u>	<u>\$ 2,556,568</u>	<u>\$ 3,008,290</u>	<u>\$ (414,944)</u>	<u>\$ 2,593,346</u>

Indefinite Life Intangible Assets

We have identified our FCC licenses and the XM trademark as indefinite life intangible assets after considering the expected use of the assets, the regulatory and economic environment within which they are used and the effects of obsolescence on their use.

We hold FCC licenses to operate our satellite digital audio radio service and provide ancillary services. The following table outlines the years in which each of our satellite licenses expires:

FCC satellite licenses	Expiration year
SIRIUS FM-1*	2017
SIRIUS FM-5	2025
SIRIUS FM-6	2022
XM-3	2021
XM-4	2022
XM-5	2018

* As of April 7, 2016, this satellite was no longer being used to transmit satellite radio. We plan to complete the deorbiting of this satellite during the fourth quarter of 2016.

Prior to expiration of our FCC licenses, we are required to apply for a renewal of our FCC licenses. The renewal and extension of our licenses is reasonably certain at minimal cost, which is expensed as incurred. Each of the FCC licenses authorizes us to use the radio spectrum, which is a renewable, reusable resource that does not deplete or exhaust over time.

Our annual impairment assessment of our identifiable indefinite lived intangible assets is performed as of the fourth quarter of each year. An assessment is performed at other times if an event occurs or circumstances change that would more likely than not reduce the fair value of the asset below its carrying value. If the carrying value of the intangible assets exceeds its fair value, an impairment loss is recognized. As of September 30, 2016, there were no indicators of impairment, and no impairment loss was recorded for intangible assets with indefinite lives during the three and nine months ended September 30, 2016 and 2015.

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Definite Life Intangible Assets

Amortization expense for all definite life intangible assets was \$12,080 and \$12,824 for the three months ended September 30, 2016 and 2015, respectively, and \$36,778 and \$39,068 for the nine months ended September 30, 2016 and 2015, respectively. Expected amortization expense for the remaining period in 2016, each of the fiscal years 2017 through 2020 and for periods thereafter is as follows:

Years ending December 31,	Amount
2016 (remaining)	\$ 11,767
2017	34,882
2018	19,463
2019	19,026
2020	18,446
Thereafter	119,330
Total definite life intangible assets, net	<u>\$ 222,914</u>

(7) Property and Equipment

Property and equipment, net, consists of the following:

	September 30, 2016	December 31, 2015
Satellite system	\$ 1,845,173	\$ 2,388,000
Terrestrial repeater network	125,266	117,127
Leasehold improvements	53,269	49,407
Broadcast studio equipment	80,425	70,888
Capitalized software and hardware	503,015	466,464
Satellite telemetry, tracking and control facilities	76,376	75,440
Furniture, fixtures, equipment and other	81,878	81,871
Land	38,411	38,411
Building	60,727	60,487
Construction in progress	145,431	101,324
Total property and equipment	<u>3,009,971</u>	<u>3,449,419</u>
Accumulated depreciation and amortization	(1,628,857)	(2,034,018)
Property and equipment, net	<u>\$ 1,381,114</u>	<u>\$ 1,415,401</u>

Construction in progress consists of the following:

	September 30, 2016	December 31, 2015
Satellite system	\$ 19,313	\$ 12,912
Terrestrial repeater network	692	25,578
Capitalized software	101,554	37,064
Other	23,872	25,770
Construction in progress	<u>\$ 145,431</u>	<u>\$ 101,324</u>

Depreciation expense on property and equipment was \$55,800 and \$57,580 for the three months ended September 30, 2016 and 2015, respectively, and \$165,437 and \$163,459 for the nine months ended September 30, 2016 and 2015, respectively. We retired property and equipment of \$583,562 and \$12,774 during the nine months ended September 30, 2016 and 2015, respectively, which included approximately \$542,827 related to satellites during 2016. We recognized a loss on

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disposal of assets of \$12,912, which has been recorded in Satellite and transmission expense in our unaudited consolidated statements of comprehensive income during the nine months ended September 30, 2016, which related to the disposal of certain obsolete spare parts for a future satellite.

We capitalize a portion of the interest on funds borrowed to finance the construction and launch of our satellites and launch vehicles. Capitalized interest is recorded as part of the asset's cost and depreciated over the satellite's useful life. Capitalized interest costs for the three and nine months ended September 30, 2016 was \$107, which related to the construction of our SXM-7 and SXM-8 satellites.

Satellites

As of September 30, 2016, we owned a fleet of six satellites, of which five were operating. The chart below provides certain information on our satellites as of September 30, 2016:

Satellite Description	Year Delivered	Estimated End of Depreciable Life
SIRIUS FM-1*	2000	2013
SIRIUS FM-5	2009	2024
SIRIUS FM-6	2013	2028
XM-3	2005	2020
XM-4	2006	2021
XM-5	2010	2025

* Satellite was fully depreciated as of September 30, 2016. As of April 7, 2016, this satellite was no longer being used to transmit satellite radio. We plan to complete the deorbiting of this satellite during the fourth quarter of 2016.

(8) Related Party Transactions

In the normal course of business, we enter into transactions with related parties.

Liberty Media

As of September 30, 2016, Liberty Media beneficially owned, directly and indirectly, approximately 65% of the outstanding shares of Holdings' common stock and has two executives and one of its directors on Holdings' board of directors. Gregory B. Maffei, the President and Chief Executive Officer of Liberty Media, is the Chairman of Holdings' board of directors. We have not had any related party transactions with Liberty Media during the three and nine months ended September 30, 2016 and 2015.

Sirius XM Holdings

Sirius XM is a wholly-owned subsidiary of Holdings. Holdings has no operations independent of Sirius XM. All equity-related transactions, including repurchases of Holdings' common stock and the issuance of equity related to stock-based compensation for Sirius XM employees, Holdings' directors and third parties have been reported as related party transactions within Sirius XM's consolidated financial statements. The stock-based compensation for Sirius XM employees, Holdings' directors and third parties has been recorded in Sirius XM's unaudited consolidated financial statements. The Related party long-term assets balance as of September 30, 2016 and December 31, 2015 of Sirius XM includes \$4,690,822 and \$3,522,162, respectively, for net amounts due from Holdings in connection with these equity-related transactions, as well as for the conversion of the 7% Exchangeable Senior Subordinated Notes in December 2014.

During the nine months ended September 30, 2016, Holdings' repurchased \$1,214,083 of its common stock, which was funded with our cash. This amount is included in our Related party long-term asset balance as a receivable due from Holdings.

Sirius XM Canada

We hold an equity method investment in Sirius XM Canada. We own approximately 47,300 of Sirius XM Canada's Class A shares on a converted basis, representing an approximate 37% equity interest and an approximate 25% voting interest. We primarily provide programming and content services to Sirius XM Canada and are reimbursed from Sirius XM

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Canada for certain product development costs, production and distribution of chipset radios, as well as for information technology and streaming support costs. Refer to Note 1 Business & Basis of Presentation for information on the pending transaction with Sirius XM Canada.

We had the following related party balances associated with Sirius XM Canada:

	<u>September 30, 2016</u>	<u>December 31, 2015</u>
Related party current assets	\$ 5,249	\$ 5,941
Related party long-term assets	\$ 6,163	\$ —
Related party current liabilities	\$ 3,015	\$ 2,840
Related party long-term liabilities	\$ 8,665	\$ 10,795

Our related party current asset balances primarily consist of activation fees and streaming and chipset costs for which we are reimbursed. Our related party long-term asset balance as of September 30, 2016 primarily included our investment balance in Sirius XM Canada. Our related party liabilities as of September 30, 2016 and December 31, 2015 included \$2,776 for the current portion of deferred revenue and \$8,557 and \$10,639, respectively, for the long-term portion of deferred revenue recorded as of the Merger date related to agreements with XM Canada, now Sirius XM Canada. These costs are being amortized on a straight line basis through 2020.

We recorded the following revenue and other income associated with Sirius XM Canada in our unaudited consolidated statements of comprehensive income:

	<u>For the Three Months Ended September 30,</u>		<u>For the Nine Months Ended September 30,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Revenue ^(a)	\$ 11,551	\$ 17,941	\$ 32,129	\$ 44,437
Other income				
Share of net earnings ^(b)	\$ 1,274	\$ —	\$ 9,725	\$ —
Dividends ^(c)	\$ —	\$ 3,891	\$ 3,575	\$ 8,880

- (a) Under our agreements with Sirius XM Canada, we currently receive a percentage-based royalty of 10% and 15% for certain types of subscription revenue earned by Sirius XM Canada for the Sirius and XM platforms, respectively; and additional royalties for premium services and royalties for activation fees and reimbursements for other charges. We record revenue from Sirius XM Canada as Other revenue in our unaudited consolidated statements of comprehensive income. The current license and services agreement entered into with Sirius Canada will expire in 2017. The current license agreement entered into with XM Canada will expire in 2020.
- (b) We recognize our proportionate share of earnings or losses of Sirius XM Canada as they occur as a component of Other income in our unaudited consolidated statements of comprehensive income on a one month lag.
- (c) Pursuant to the Arrangement Agreement, Sirius XM Canada did not pay any dividends during the three months ended September 30, 2016. Sirius XM Canada paid gross dividends to us of \$3,891 during the three months ended September 30, 2015 and \$7,548 and \$11,881 during the nine months ended September 30, 2016 and 2015, respectively. These dividends were first recorded as a reduction to our investment balance in Sirius XM Canada to the extent a balance existed and then as Other income for the remaining portion.

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(9) Debt

Our debt as of September 30, 2016 and December 31, 2015 consisted of the following:

Issuer / Borrower	Issued	Debt	Maturity Date	Interest Payable	Principal Amount at September 30, 2016	Carrying value ^(a) at	
						September 30, 2016	December 31, 2015
Sirius XM (b)	May 2013	4.25% Senior Notes (the "4.25% Notes")	May 15, 2020	semi-annually on May 15 and November 15	\$ 500,000	\$ 496,869	\$ 496,282
Sirius XM (b)(f)	September 2013	5.875% Senior Notes (the "5.875% Notes")	October 1, 2020	semi-annually on April 1 and October 1	650,000	645,456	644,720
Sirius XM (b)	August 2013	5.75% Senior Notes (the "5.75% Notes")	August 1, 2021	semi-annually on February 1 and August 1	600,000	596,216	595,720
Sirius XM (b)	May 2013	4.625% Senior Notes (the "4.625% Notes")	May 15, 2023	semi-annually on May 15 and November 15	500,000	495,982	495,602
Sirius XM (b)	May 2014	6.00% Senior Notes (the "6.00% Notes")	July 15, 2024	semi-annually on January 15 and July 15	1,500,000	1,486,208	1,485,196
Sirius XM (b)	March 2015	5.375% Senior Notes (the "5.375% Notes due 2025")	April 15, 2025	semi-annually on April 15 and October 15	1,000,000	990,112	989,446
Sirius XM (b)(c)	May 2016	5.375% Senior Notes (the "5.375% Notes due 2026")	July 15, 2026	semi-annually on January 15 and July 15	1,000,000	989,047	—
Sirius XM (b)(d)	August 2012	5.25% Senior Secured Notes (the "5.25% Notes")	August 15, 2022	semi-annually on February 15 and August 15	400,000	396,090	395,675
Sirius XM (e)	December 2012	Senior Secured Revolving Credit Facility (the "Credit Facility")	June 16, 2020	variable fee paid quarterly	1,750,000	—	340,000
Sirius XM	Various	Capital leases	Various	n/a	n/a	14,192	12,892
Total Debt						6,110,172	5,455,533
Less: total current maturities (f)						358,701	4,764
Less: total deferred financing costs for Notes						8,082	7,155
Total long-term debt						\$ 5,743,389	\$ 5,443,614

- (a) The carrying value of the obligations is net of any remaining unamortized original issue discount.
- (b) Substantially all of our domestic wholly-owned subsidiaries have guaranteed these notes.
- (c) In May 2016, we issued \$1,000,000 aggregate principal amount of 5.375% Senior Notes due 2026, with an original issuance discount of \$11,250.
- (d) The liens securing the 5.25% Notes are equal and ratable to the liens granted to secure the Credit Facility.
- (e) Our obligations under the Credit Facility are guaranteed by certain of our material domestic subsidiaries and are secured by a lien on substantially all of our assets and the assets of its material domestic subsidiaries. Interest on borrowings is payable on a monthly basis and accrues at a rate based on LIBOR plus an applicable rate. We are also required to pay a variable fee on the average daily unused portion of the Credit Facility which is payable on a quarterly basis. The variable rate for the unused portion of the Credit Facility was 0.25% per annum as of September 30, 2016. Our outstanding borrowings under the Credit Facility are classified as Long-term debt within our unaudited consolidated balance sheets due to the long-term maturity of this debt. For a discussion of subsequent events refer to Note 14.
- (f) On August 25, 2016, we called for the redemption of \$650,000 outstanding principal balance of the 5.875% Notes on October 1, 2016. As of September 30, 2016, \$353,965 of the 5.875% Notes, which is net of \$5,132 of original issue discount and deferred financing costs, was classified as current maturities of long-term debt and \$290,903 of principal amount was classified as long-term debt within our unaudited consolidated balance sheets. For a discussion of subsequent events refer to Note 14.

Covenants and Restrictions

Under the Credit Facility, we must comply with a debt maintenance covenant that it not exceed a total leverage ratio, calculated as consolidated total debt to consolidated operating cash flow, of 5.0 to 1.0. The Credit Facility generally requires

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compliance with certain covenants that restrict our ability to, among other things, (i) incur additional indebtedness, (ii) incur liens, (iii) pay dividends or make certain other restricted payments, investments or acquisitions, (iv) enter into certain transactions with affiliates, (v) merge or consolidate with another person, (vi) sell, assign, lease or otherwise dispose of all or substantially all of our assets, and (vii) make voluntary prepayments of certain debt, in each case subject to exceptions.

The indentures governing our notes restrict our non-guarantor subsidiaries' ability to create, assume, incur or guarantee additional indebtedness without such non-guarantor subsidiary guaranteeing each such series of notes on a pari passu basis. The indentures governing the notes also contain covenants that, among other things, limit our ability and the ability of its subsidiaries to create certain liens; enter into sale/leaseback transactions; and merge or consolidate.

Under our debt agreements, the following generally constitute an event of default: (i) a default in the payment of interest; (ii) a default in the payment of principal; (iii) failure to comply with covenants; (iv) failure to pay other indebtedness after final maturity or acceleration of other indebtedness exceeding a specified amount; (v) certain events of bankruptcy; (vi) a judgment for payment of money exceeding a specified aggregate amount; and (vii) voidance of subsidiary guarantees, subject to grace periods where applicable. If an event of default occurs and is continuing, our debt could become immediately due and payable.

At September 30, 2016 and December 31, 2015, we were in compliance with our debt covenants.

(10) Stockholder Equity

Common Stock, par value \$0.001 per share

We are authorized to issue up to 9,000,000 shares of common stock. As of September 30, 2016 and December 31, 2015, there were one thousand shares of common stock of Sirius XM issued and outstanding, which was owned by Holdings.

Preferred Stock, par value \$0.001 per share

We are authorized to issue up to 50,000 shares of undesignated preferred stock with a liquidation preference of \$0.001 per share. There were no shares of preferred stock issued or outstanding as of September 30, 2016 and December 31, 2015.

(11) Benefit Plans

We recognized share-based payment expense of \$30,020 and \$23,393 for the three months ended September 30, 2016 and 2015, respectively, and \$77,890 and \$62,334 for the nine months ended September 30, 2016 and 2015, respectively.

2015 Long-Term Stock Incentive Plan

In May 2015, Holdings' stockholders approved the Sirius XM Holdings Inc. 2015 Long-Term Stock Incentive Plan (the "2015 Plan"). Employees, consultants and members of Holdings' board of directors are eligible to receive awards under the 2015 Plan. The 2015 Plan provides for the grant of stock options, restricted stock awards, restricted stock units and other stock-based awards that the compensation committee of Holdings' board of directors deem appropriate. Stock-based awards granted under the 2015 Plan are generally subject to a graded vesting requirement, which is generally three to four years from the grant date, and may include performance requirements. Stock options generally expire ten years from the date of grant. Each restricted stock unit entitles the holder to receive one share of common stock upon vesting. As of September 30, 2016, 181,711 shares of Holdings' common stock were available for future grants under the 2015 Plan.

Other Plans

We maintain four other share-based benefit plans — the Sirius XM Radio Inc. 2009 Long-Term Stock Incentive Plan, the XM 2007 Stock Incentive Plan, the Amended and Restated Sirius Satellite Radio 2003 Long-Term Stock Incentive Plan and the XM 1998 Shares Award Plan. No further awards may be made under these plans.

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The following table summarizes the weighted-average assumptions used to compute the fair value of options granted to employees and members of Holdings' board of directors:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Risk-free interest rate	1.1%	1.4%	1.1%	1.4%
Expected life of options — years	4.48	4.22	4.27	4.20
Expected stock price volatility	22%	26%	22%	26%
Expected dividend yield	0%	0%	0%	0%

There were no options granted to third parties during the three and nine months ended September 30, 2016 and 2015. Since Holdings has not historically paid dividends on its common stock, the dividend yield used in the Black-Scholes-Merton option value was zero for all periods.

The following table summarizes stock option activity under our share-based plans for the nine months ended September 30, 2016:

	Options	Weighted- Average Exercise Price Per Share	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2015	338,481	\$ 3.29		
Granted	53,346	\$ 4.13		
Exercised	(36,824)	\$ 2.58		
Forfeited, cancelled or expired	(9,992)	\$ 4.32		
Outstanding as of September 30, 2016	345,011	\$ 3.47	7.49	\$ 244,220
Exercisable as of September 30, 2016	137,541	\$ 2.80	6.14	\$ 188,511

The weighted average grant date fair value per share of options granted during the nine months ended September 30, 2016 was \$0.83. The total intrinsic value of stock options exercised during the nine months ended September 30, 2016 and 2015 was \$59,531 and \$85,387, respectively.

We recognized share-based payment expense associated with stock options of \$21,484 and \$19,418 for the three months ended September 30, 2016 and 2015, respectively, and \$59,510 and \$52,662 for the nine months ended September 30, 2016 and 2015, respectively.

The following table summarizes the restricted stock unit, including performance-based restricted stock units ("PRSUs"), and stock award activity under our share-based plans for the nine months ended September 30, 2016:

	Shares	Grant Date Fair Value Per Share
Nonvested as of December 31, 2015	16,088	\$ 3.73
Granted	17,453	\$ 4.21
Vested	(4,009)	\$ 3.66
Forfeited	(456)	\$ 3.71
Nonvested as of September 30, 2016	29,076	\$ 4.02

The total intrinsic value of restricted stock units and stock awards vesting during the nine months ended September 30, 2016 and 2015 was \$16,890 and \$9,565, respectively.

On August 5, 2016, we granted 3,036 PRSUs to certain employees, the vesting of which is subject to the employee's continuing employment and Holdings' achievement of certain performance goals. The awards cliff vest on the three-year anniversary of the grant date. We believe it is probable that the performance target applicable to these PRSUs will be achieved.

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We recognized share-based payment expense associated with restricted stock units and stock awards of \$8,536 and \$3,975 during the three months ended September 30, 2016 and 2015, respectively, and \$18,380 and \$9,672 for the nine months ended September 30, 2016 and 2015, respectively. The three months ended September 30, 2016 included \$669 of compensation expense related to PRSUs.

Total unrecognized compensation costs related to unvested share-based payment awards for stock options and restricted stock units granted to employees, members of Holdings' board of directors and third parties at September 30, 2016 and December 31, 2015 were \$281,678 and \$261,628, respectively. The total unrecognized compensation costs at September 30, 2016 are expected to be recognized over a weighted-average period of 2.7 years.

401(k) Savings Plan

Sirius XM sponsors the Sirius XM Radio Inc. 401(k) Savings Plan (the "Sirius XM Plan") for eligible employees. The Sirius XM Plan allows eligible employees to voluntarily contribute from 1% to 50% of their pre-tax eligible earnings, subject to certain defined limits. We match 50% of an employee's voluntary contributions per pay period on the first 6% of an employee's pre-tax salary up to a maximum of 3% of eligible compensation. We may also make additional discretionary matching, true-up matching and non-elective contributions to the Sirius XM Plan. Employer matching contributions under the Sirius XM Plan vest at a rate of 33.33% for each year of employment and are fully vested after three years of employment for all current and future contributions. Our cash employer matching contributions are not used to purchase shares of Holdings' common stock on the open market, unless the employee elects Holdings' common stock as their investment option for this contribution. We recognized \$1,640 and \$1,486 in expense during the three months ended September 30, 2016 and 2015, respectively, and \$4,857 and \$6,026 in expense during nine months ended September 30, 2016 and 2015, respectively.

Sirius XM Holdings Inc. Deferred Compensation Plan

In 2015, Holdings' adopted the Sirius XM Holdings Inc. Deferred Compensation Plan (the "DCP"). The DCP allows members of Holdings' board of directors and certain eligible employees to defer all or a portion of their base salary, cash incentive compensation and/or board of directors' compensation, as applicable, each plan year starting in 2016. Pursuant to the terms of the DCP, Holdings or any of its subsidiaries may elect to make additional contributions beyond amounts deferred by participants, but is under no obligation to do so. Holdings has established a grantor (or "rabbi") trust to facilitate the payment of its obligations under the DCP.

As of September 30, 2016, the fair value of the investments in the trust was \$4,625, which is included in Other long-term assets in our unaudited consolidated balance sheets and is classified as trading securities. Trading gains and losses associated with the trust are recorded in Other income within our unaudited consolidated statements of comprehensive income. The associated liability is recorded within Other long-term liabilities in our unaudited consolidated balance sheets, and any increase or decrease in the liability is recorded in General and administration expense within our unaudited consolidated statements of comprehensive income.

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(12) Commitments and Contingencies

The following table summarizes our expected contractual cash commitments as of September 30, 2016:

	2016	2017	2018	2019	2020	Thereafter	Total
Debt obligations	\$ 359,733	\$ 5,485	\$ 4,477	\$ 3,169	\$ 791,328	\$ 5,000,000	\$ 6,164,192
Cash interest payments	69,363	348,034	340,140	340,041	328,098	1,058,688	2,484,364
Satellite and transmission	29,594	94,416	68,300	51,927	25,721	24,756	294,714
Programming and content	58,968	302,814	279,001	260,155	222,332	356,825	1,480,095
Marketing and distribution	9,163	17,304	15,744	12,986	7,445	7,400	70,042
Satellite incentive payments	3,176	13,296	14,302	10,652	9,310	79,785	130,521
Operating lease obligations	7,620	44,917	43,425	39,279	36,764	180,791	352,796
Other	21,175	25,515	8,519	1,209	380	40	56,838
Total ⁽¹⁾	<u>\$ 558,792</u>	<u>\$ 851,781</u>	<u>\$ 773,908</u>	<u>\$ 719,418</u>	<u>\$ 1,421,378</u>	<u>\$ 6,708,285</u>	<u>\$ 11,033,562</u>

(1) The table does not include our reserve for uncertain tax positions, which at September 30, 2016 totaled \$5,427, as the specific timing of any cash payments cannot be projected with reasonable certainty.

Debt obligations. Debt obligations include principal payments on outstanding debt and capital lease obligations.

Cash interest payments. Cash interest payments include interest due on outstanding debt and capital lease payments through maturity.

Satellite and transmission. We have entered into agreements with third parties to operate and maintain the off-site satellite telemetry, tracking and control facilities and certain components of our terrestrial repeater networks. During the quarter ended September 30, 2016, we entered into an agreement with Space Systems/Loral to design and build two replacement satellites, SXM-7 and SXM-8, for our service.

Programming and content. We have entered into various programming agreements. Under the terms of these agreements, our obligations include fixed payments, advertising commitments and revenue sharing arrangements. Our future revenue sharing costs are dependent upon many factors and are difficult to estimate; therefore, they are not included in our minimum contractual cash commitments.

Marketing and distribution. We have entered into various marketing, sponsorship and distribution agreements to promote our brand and are obligated to make payments to sponsors, retailers, automakers and radio manufacturers under these agreements. Certain programming and content agreements also require us to purchase advertising on properties owned or controlled by the licensors. We also reimburse automakers for certain engineering and development costs associated with the incorporation of satellite radios into new vehicles they manufacture.

Satellite incentive payments. Boeing Satellite Systems International, Inc., the manufacturer of certain of our in-orbit satellites, may be entitled to future in-orbit performance payments with respect to XM-3 and XM-4 meeting their fifteen-year design life, which we expect to occur. Boeing may also be entitled to additional incentive payments up to \$10,000 if our XM-4 satellite continues to operate above baseline specifications during the five years beyond the satellite's fifteen-year design life.

Space Systems/Loral, the manufacturer of certain of our in-orbit satellites, may be entitled to future in-orbit performance payments with respect to XM-5, FM-5 and FM-6 meeting their fifteen-year design life, which we expect to occur.

Operating lease obligations. We have entered into both cancelable and non-cancelable operating leases for office space, equipment and terrestrial repeaters. These leases provide for minimum lease payments, additional operating expense charges, leasehold improvements and rent escalations that have initial terms ranging from one to fifteen years, and certain leases have options to renew. The effect of the rent holidays and rent concessions are recognized on a straight-line basis over the lease term, including reasonably assured renewal periods.

Other. We have entered into various agreements with third parties for general operating purposes. In addition to the minimum contractual cash commitments described above, we have entered into agreements with other variable cost

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arrangements. These future costs are dependent upon many factors and are difficult to anticipate; however, these costs may be substantial. We may enter into additional programming, distribution, marketing and other agreements that contain similar variable cost provisions. The cost of Holdings' stock acquired but not paid for as of September 30, 2016 is also included in this category.

We do not have any other significant off-balance sheet financing arrangements that are reasonably likely to have a material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Legal Proceedings

In the ordinary course of business, we are a defendant or party to various claims and lawsuits, including those discussed below.

We record a liability when we believe that it is both probable that a liability will be incurred, and the amount of loss can be reasonably estimated. We evaluate developments in legal matters that could affect the amount of liability that has been previously accrued and make adjustments as appropriate. Significant judgment is required to determine both probability and the estimated amount of a loss or potential loss. We may be unable to reasonably estimate the reasonably possible loss or range of loss for a particular legal contingency for various reasons, including, among others, because: (i) the damages sought are indeterminate; (ii) the proceedings are in the relative early stages; (iii) there is uncertainty as to the outcome of pending proceedings (including motions and appeals); (iv) there is uncertainty as to the likelihood of settlement and the outcome of any negotiations with respect thereto; (v) there remain significant factual issues to be determined or resolved; (vi) the relevant law is unsettled; or (vii) the proceedings involve novel or untested legal theories. In such instances, there may be considerable uncertainty regarding the ultimate resolution of such matters, including a possible eventual loss, if any.

Telephone Consumer Protection Act Suits. We are a defendant in several purported class action suits that allege that we, or call center vendors acting on our behalf, made calls which violate provisions of the Telephone Consumer Protection Act of 1991 (the "TCPA"). The plaintiffs in these actions allege, among other things, that we called mobile phones using an automatic telephone dialing system without the consumer's prior consent or, alternatively, after the consumer revoked his or her prior consent. In one of the actions, the plaintiff also alleges that we violated the TCPA's call time restrictions and, in one of the other actions, the plaintiff also alleges that we violated the TCPA's do not call restrictions. These purported class action cases are titled Erik Knutson v. Sirius XM Radio Inc., No. 12-cv-0418-AJB-NLS (S.D. Cal.), Francis W. Hooker v. Sirius XM Radio Inc., No. 4:13-cv-3 (E.D. Va.), Yefim Elikman v. Sirius XM Radio Inc. and Career Horizons, Inc., No. 1:15-cv-02093 (N.D. Ill.), and Anthony Parker v. Sirius XM Radio Inc., No. 8:15-cv-01710-JSM-EAJ (M.D. Fla), and are described in Item 3., Legal Proceedings, in our Annual Report on Form 10-K for the year ended December 31, 2015.

We have entered into an agreement to settle these purported class action suits. The settlement is expected to resolve the claims of consumers beginning in February 2008 relating to telemarketing calls to their mobile telephones. As part of this settlement, we have made a \$35,000 payment to a settlement fund (from which notice, administration and other costs and attorneys' fees will be paid), and are offering participating class members the option of receiving three months of our Select service for no charge, and will enter into agreements to make modifications to the practices of certain call center vendors. The settlement is subject to final court approval, which cannot be assured.

Pre-1972 Sound Recording Matters. In August 2013, SoundExchange, Inc. filed a complaint in the United States District Court for the District of Columbia alleging that we underpaid royalties for statutory licenses during the 2007-2012 period in violation of the regulations established by the Copyright Royalty Board for that period. SoundExchange principally alleges that we improperly reduced our calculation of gross revenues, on which the royalty payments are based, by deducting non-recognized revenue attributable to pre-1972 recordings and Premier package revenue that is not "separately charged" as required by the regulations. SoundExchange is seeking compensatory damages of not less than \$50,000 and up to \$100,000 or more, payment of late fees and interest, and attorneys' fees and costs.

In August 2014, the United States District Court for the District of Columbia granted our motion to dismiss the complaint without prejudice on the grounds that the case properly should be pursued before the Copyright Royalty Board rather than the district court. In December 2014, SoundExchange filed a petition with the Copyright Royalty Board requesting an order interpreting the applicable regulations. We have submitted legal briefs and other evidence supporting our position that our payments and practices complied with the regulations established by the Copyright Royalty Board for statutory licenses

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

during the 2007-2012 period or, in the event that the Judges should find that the applicable regulations were unclear, that the Judges should clarify the regulations and confirm that our payments and practices complied with the regulations for that period. Briefing in this matter is complete and a decision from the Copyright Royalty Board is pending.

This matter is titled SoundExchange, Inc. v. Sirius XM Radio, Inc., No.13-cv-1290-RJL (D.D.C.), and *Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, United States Copyright Royalty Board, No. 2006-1 CRB DSTRA. Information concerning the action is publicly available in filings under the docket numbers. The outcome of this matter is inherently unpredictable and subject to significant uncertainties, many of which are beyond our control. No provision was made for losses to the extent such are not probable and estimable. We believe we have substantial defenses to the claims asserted, and intend to defend this action vigorously.

Other Matters. In the ordinary course of business, we are a defendant in various other lawsuits and arbitration proceedings, including derivative actions; actions filed by subscribers, both on behalf of themselves and on a class action basis; former employees; parties to contracts or leases; and owners of patents, trademarks, copyrights or other intellectual property. None of these other matters, in our opinion, is likely to have a material adverse effect on our business, financial condition or results of operations.

(13) Income Taxes

For the three months ended September 30, 2016 and 2015, income tax expense was \$111,556 and \$112,543, respectively. For the nine months ended September 30, 2016 and 2015, income tax expense was \$326,108 and \$296,893, respectively.

Our effective tax rate for the three and nine months ended September 30, 2016 was 36.5% and 37.6%, respectively. Our effective tax rate for the three and nine months ended September 30, 2015 was 40.3% and 44.2%, respectively. Our effective tax rate for the nine months ended September 30, 2015 was impacted by tax law changes in the District of Columbia and New York City. The tax law change in the District of Columbia will reduce our future tax and thus we will use less of certain net operating losses in the future which resulted in a \$44,392 increase in our valuation allowance during the three months ended March 31, 2015. The tax law change in New York City will increase certain net operating losses to be utilized in the future which resulted in a \$14,831 increase in our deferred tax asset during the three months ended June 30, 2015.

As of September 30, 2016 and December 31, 2015, we had a valuation allowance related to deferred tax assets of \$49,257 and \$49,095, respectively, that were not likely to be realized due to certain net operating loss limitations and acquired net operating losses that were not more likely than not going to be utilized.

(14) Subsequent Events

Debt Redemption

On October 1, 2016, we redeemed \$650,000 in principal amount of our outstanding 5.875% Notes for an approximate purchase price of \$669,097, including premium, which will result in the recognition of a Loss on extinguishment of debt and credit facilities, net, of approximately \$24,229 in the fourth quarter of 2016. This redemption was funded with \$359,097 of Cash and cash equivalents and \$310,000 of additional borrowings under our Credit Facility.

Holdings' Capital Return Program

For the period from October 1, 2016 to October 25, 2016, we repurchased \$76,791 of Holdings' common stock on the open market, including fees and commissions.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)

(Dollars and shares in thousands, except per share amounts)

On October 26, 2016, Holdings' board of directors approved an additional \$2,000,000 for repurchase of Holdings' common stock. The new approval increases the amount of common stock that we have been authorized to repurchase to an aggregate of \$10,000,000. Shares of Holdings' common stock may be purchased from time to time on the open market and in privately negotiated transactions, including in accelerated stock repurchase transactions and transactions with Liberty Media and its affiliates. We intend to fund the additional repurchases of Holdings' common stock through a combination of cash on hand, cash generated by operations and future borrowings.

On October 26, 2016, Holdings' board of directors also declared the first quarterly dividend on Holdings' common stock in the amount of \$0.01 per share of common stock payable on November 30, 2016 to stockholders of record as of the close of business on November 9, 2016. Holdings' board of directors expects that this dividend will be the first of regular quarterly dividends, in an aggregate annual amount of \$0.04 per share of common stock.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

All amounts referenced in this discussion and analysis are in thousands, except per subscriber and per installation amounts, unless otherwise stated.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and related notes included elsewhere in this Quarterly Report and with Holdings' Annual Report on Form 10-K for the year ended December 31, 2015.

Special Note Regarding Forward-Looking Statements

The following cautionary statements identify important factors that could cause our actual results to differ materially from those projected in forward-looking statements made in this Quarterly Report and in other reports and documents published by us from time to time. Any statements about our beliefs, plans, objectives, expectations, assumptions, future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as "will likely result," "are expected to," "will continue," "is anticipated," "estimated," "intend," "plan," "projection" and "outlook." Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this Quarterly Report and in other reports and documents published by us from time to time, particularly the risk factors described under "Risk Factors" in Part I, Item 1A, of Holdings' Form 10-K for the year ended December 31, 2015 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein and in Part II, Item 7, of Holdings' Annual Report on Form 10-K for the year ended December 31, 2015.

Among the significant factors that could cause our actual results to differ materially from those expressed in the forward-looking statements are:

- we face substantial competition and that competition is likely to increase over time;
- our ability to attract and retain subscribers in the future is uncertain;
- consumer protection laws and their enforcement could damage our business;
- the unfavorable outcome of pending or future litigation;
- the market for music rights is changing and is subject to significant uncertainties;
- our business depends in large part upon the auto industry;
- general economic conditions can affect our business;
- if we fail to protect the security of personal information about our customers, we could be subject to costly government enforcement actions and private litigation and our reputation could suffer;
- other existing or future government laws and regulations could harm our business;
- failure of our satellites would significantly damage our business;
- interruption or failure of our information technology and communications systems could negatively impact our results and our brand;
- we may not realize the benefits of acquisitions or other strategic initiatives;
- rapid technological and industry changes could adversely impact our services;
- failure of third parties to perform could adversely affect our business;
- our service may experience harmful interference from new and existing wireless operations;
- failure to comply with FCC requirements could damage our business;
- we may from time to time modify our business plan, and these changes could adversely affect us and our financial condition;
- we have a significant amount of indebtedness, and our revolving credit facility contains certain covenants that restrict our current and future operations;
- our studios, terrestrial repeater networks, satellite uplink facilities or other ground facilities could be damaged by natural catastrophes or terrorist activities;

- Holdings' principal stockholder has significant influence, including over actions requiring stockholder approval, and its interests may differ from the interests of other holders of its common stock;
- Holdings' is a “controlled company” within the meaning of the NASDAQ listing rules and, as a result, qualifies for, and relies on, exemptions from certain corporate governance requirements; and
- our business may be impaired by third-party intellectual property rights.

Because the risk factors referred to above could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made by us or on our behalf, you should not place undue reliance on any of these forward-looking statements. In addition, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which the statement is made, to reflect the occurrence of unanticipated events or otherwise, except as required by law. New factors emerge from time to time, and it is not possible for us to predict which will arise or to assess with any precision the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Executive Summary

We transmit music, sports, entertainment, comedy, talk, news, traffic and weather channels, as well as infotainment services, in the United States on a subscription fee basis through our two proprietary satellite radio systems. Subscribers can also receive music and other channels, plus features such as SiriusXM On Demand and MySXM, over our Internet radio service, including through applications for mobile devices. We are also a leader in providing connected vehicle services. Our connected vehicle services are designed to enhance the safety, security and driving experience for vehicle operators while providing marketing and operational benefits to automakers and their dealers.

We have agreements with every major automaker (“OEMs”) to offer satellite radio in their vehicles. We also acquire subscribers through marketing to owners and lessees of previously owned vehicles that include factory-installed satellite radios that are not currently subscribing to our services. Additionally, we distribute our satellite radios through retailers online and at locations nationwide and through our website. Satellite radio services are also offered to customers of certain rental car companies.

As of September 30, 2016, we had approximately 31.0 million subscribers of which approximately 25.5 million were self-pay subscribers and approximately 5.5 million were paid promotional subscribers. Our subscriber totals include subscribers under our regular pricing plans; discounted pricing plans; subscribers that have prepaid, including payments either made or due from automakers for subscriptions included in the sale or lease price of a vehicle; subscribers to our Internet services who do not also have satellite radio subscriptions; and certain subscribers to our weather, traffic, and data services who do not also have satellite radio subscriptions. Subscribers and subscription related revenues and expenses associated with our connected vehicle services and the Sirius XM Canada service are not included in our subscriber count or subscriber-based operating metrics.

Our primary source of revenue is subscription fees, with most of our customers subscribing on an annual, semi-annual, quarterly or monthly plan. We offer discounts for prepaid, longer term subscription plans, as well as a multiple subscription discount. We also derive revenue from activation and other fees, the sale of advertising on select non-music channels, the direct sale of satellite radios and accessories, and other ancillary services, such as our weather, traffic and data services.

In certain cases, a subscription to our radio services is included in the sale or lease price of new vehicles or previously owned vehicles. The length of these subscriptions varies but is typically three to twelve months. We receive payments for these subscriptions from certain automakers. We also reimburse various automakers for certain costs associated with satellite radios installed in new vehicles.

As of September 30, 2016, Liberty Media beneficially owned, directly and indirectly, approximately 65% of the outstanding shares of Holdings' common stock. As a result, Holdings is a “controlled company” for the purposes of the NASDAQ corporate governance requirements. Liberty Media owns interests in a range of media, communications and entertainment businesses.

Recent Development

Recapitalization of Sirius XM Canada

On May 12, 2016, we entered into an arrangement agreement (the “Arrangement Agreement”) with Sirius XM Canada Holdings Inc. (“Sirius XM Canada”), an entity in which we currently hold an approximate 37% economic interest and 25% voting interest. Pursuant to the Arrangement Agreement, the Company and certain Canadian shareholders will form a new company to acquire shares of Sirius XM Canada not already owned by us and certain Canadian shareholders pursuant to a plan of arrangement (the “Transaction”). In connection with the Transaction, Sirius XM Canada’s shareholders will be entitled to elect to receive, for each share of Sirius XM Canada held, C\$4.50 (U.S. \$3.50 as of May 12, 2016) in (i) cash, (ii) shares of Holdings' common stock, (iii) a security exchangeable for shares of Holdings' common stock, or (iv) a combination thereof; provided that no more than 50% of the total consideration in the Transaction (or up to 35,000 shares) will be issued in Holdings' common stock and exchangeable shares. All of the obligations under the Arrangement Agreement are guaranteed by us.

Following the Transaction, we are expected to hold a 70% economic interest and 33% voting interest in Sirius XM Canada, with the remainder of the voting power and economic interest held by Slight Communications and Obelisk Media, two of Sirius XM Canada’s current Canadian shareholders. We expect to contribute to Sirius XM Canada approximately U.S. \$275,000 in connection with the Transaction (assuming that all shareholders elect to receive cash in connection with the Transaction), which amount is expected to be used to pay the cash consideration to Sirius XM Canada’s shareholders and will be decreased proportionately if shareholders elect to receive consideration in shares of Holdings' common stock or securities exchangeable for Holdings' common stock.

The Transaction has been approved by the stockholders of Sirius XM Canada and has received the required court approval. The Transaction remains subject to receipt of Canadian Radio-Television and Telecommunications Commission approval. Pending receipt of this approval, the Transaction is expected to close in the fourth quarter of 2016.

Results of Operations

Set forth below are our results of operations for the three and nine months ended September 30, 2016 compared with the three and nine months ended September 30, 2015.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		2016 vs 2015 Change			
	2016	2015	2016	2015	Three Months		Nine Months	
					Amount	%	Amount	%
Revenue:								
Subscriber revenue	\$1,069,746	\$ 974,471	\$3,112,712	\$2,826,018	\$ 95,275	10 %	\$ 286,694	10 %
Advertising revenue	34,268	33,131	99,330	88,843	1,137	3 %	10,487	12 %
Equipment revenue	31,306	25,875	86,285	79,979	5,431	21 %	6,306	8 %
Other revenue	142,326	136,235	415,895	379,072	6,091	4 %	36,823	10 %
Total revenue	1,277,646	1,169,712	3,714,222	3,373,912	107,934	9 %	340,310	10 %
Operating expenses:								
Cost of services:								
Revenue share and royalties	272,823	238,620	788,952	783,115	34,203	14 %	5,837	1 %
Programming and content	89,015	75,707	257,760	216,223	13,308	18 %	41,537	19 %
Customer service and billing	94,923	94,492	285,502	278,521	431	0 %	6,981	3 %
Satellite and transmission	22,224	22,743	80,609	65,761	(519)	(2)%	14,848	23 %
Cost of equipment	9,674	9,246	29,181	29,021	428	5 %	160	1 %
Subscriber acquisition costs	120,111	133,009	381,516	391,773	(12,898)	(10)%	(10,257)	(3)%
Sales and marketing	99,194	90,541	279,278	255,778	8,653	10 %	23,500	9 %
Engineering, design and development	19,254	16,132	57,588	47,180	3,122	19 %	10,408	22 %
General and administrative	90,369	67,234	249,052	219,194	23,135	34 %	29,858	14 %
Depreciation and amortization	67,880	70,404	202,215	202,527	(2,524)	(4)%	(312)	0 %
Total operating expenses	885,467	818,128	2,611,653	2,489,093	67,339	8 %	122,560	5 %
Income from operations	392,179	351,584	1,102,569	884,819	40,595	12 %	217,750	25 %
Other income (expense):								
Interest expense	(89,092)	(76,624)	(250,888)	(221,912)	(12,468)	(16)%	(28,976)	(13)%
Other income	2,370	4,133	15,733	9,077	(1,763)	(43)%	6,656	73 %
Total other expense	(86,722)	(72,491)	(235,155)	(212,835)	(14,231)	(20)%	(22,320)	(10)%
Income before income taxes	305,457	279,093	867,414	671,984	26,364	9 %	195,430	29 %
Income tax expense	(111,556)	(112,543)	(326,108)	(296,893)	987	1 %	(29,215)	(10)%
Net income	\$ 193,901	\$ 166,550	\$ 541,306	\$ 375,091	\$ 27,351	16 %	\$ 166,215	44 %

Total Revenue

Subscriber Revenue includes subscription, activation and other fees.

For the three months ended September 30, 2016 and 2015, subscriber revenue was \$1,069,746 and \$974,471, respectively, an increase of 10%, or \$95,275. For the nine months ended September 30, 2016 and 2015, subscriber revenue was \$3,112,712 and \$2,826,018, respectively, an increase of 10%, or \$286,694. The period over period increase was primarily attributable to a 7% and 8% increase in daily weighted average number of subscribers for the

three and nine months ended September 30, 2016, respectively, as well as a 3% increase in average monthly revenue per subscriber resulting from our price changes and mix of plans.

We expect subscriber revenues to increase based on the growth of our subscriber base, the effects of increases in certain of our subscription rates and the sale of additional services to subscribers.

Advertising Revenue includes the sale of advertising on certain non-music channels.

For the three months ended September 30, 2016 and 2015, advertising revenue was \$34,268 and \$33,131, respectively, an increase of 3%, or \$1,137. For the nine months ended September 30, 2016 and 2015, advertising revenue was \$99,330 and \$88,843, respectively, an increase of 12%, or \$10,487. For the three months ended September 30, 2016, the increase was primarily due to a greater number of advertising spots sold and transmitted, partially offset by the loss of a significant advertiser due to state regulatory activities surrounding the fantasy sports industry. For the nine months ended September 30, 2016, the increase was primarily due to a greater number of advertising spots sold and transmitted as well as increased rates per spot.

We expect our advertising revenue to continue to grow as more advertisers are attracted to our national platform and growing subscriber base and as we launch additional non-music channels.

Equipment Revenue includes revenue and royalties from the sale of satellite radios, components and accessories.

For the three months ended September 30, 2016 and 2015, equipment revenue was \$31,306 and \$25,875, respectively, an increase of 21%, or \$5,431. For the nine months ended September 30, 2016 and 2015, equipment revenue was \$86,285 and \$79,979, respectively, an increase of 8%, or \$6,306. The period over period increase for the three months and nine months ended September 30, 2016 was driven by an increase in OEM production and an increase in royalty revenue on certain modules starting early in the second quarter of 2016, partially offset by lower sales through our aftermarket and direct to consumer businesses.

We expect equipment revenue to fluctuate based on OEM production for which we receive royalty payments for our technology and, to a lesser extent, on the volume of equipment sales in our aftermarket and direct to consumer businesses.

Other Revenue includes amounts earned from subscribers for the U.S. Music Royalty Fee, and revenue from our connected vehicle services, our Canadian affiliate and ancillary revenues.

For the three months ended September 30, 2016 and 2015, other revenue was \$142,326 and \$136,235, respectively, an increase of 4%, or \$6,091. For the nine months ended September 30, 2016 and 2015, other revenue was \$415,895 and \$379,072, respectively, an increase of 10%, or \$36,823. The period over period increase was primarily driven by revenues from the U.S. Music Royalty Fee due to an increase in the number of subscribers and subscribers paying at a higher rate. These increases were offset by lower activation revenues and a change in a programming contract in the third quarter of 2015 related to our Canadian affiliate and the timing of non-recurring engineering fees from our connected vehicle services.

We expect other revenue to increase as our growing subscriber base drives higher U.S. Music Royalty Fees.

Operating Expenses

Revenue Share and Royalties include distribution and content provider revenue share, royalties for transmitting content and web streaming, and advertising revenue share.

For the three months ended September 30, 2016 and 2015, revenue share and royalties were \$272,823 and \$238,620, respectively, an increase of 14%, or \$34,203, and increased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, revenue share and royalties were \$788,952 and \$783,115, respectively, an increase of 1%, or \$5,837, but decreased as a percentage of total revenue. The increase for the three and nine month period was due to overall greater revenues subject to royalty and revenue sharing arrangements, and a 5% increase in the statutory royalty rate applicable to our use of post-1972 recordings. The increase in the nine month period was mitigated by the impact of \$116,639 in expense recorded during the nine months ended September 30, 2015 for the portion of the \$210,000 settlement of the [Capitol Records LLC et al. v. Sirius XM Radio Inc.](#) lawsuit related to our use of pre-1972 sound recordings through September 30, 2015. We have recorded approximately \$29,654 related to this settlement through the nine months ended September 30, 2016.

We expect our revenue share and royalty costs to increase as our revenues grow and as the statutory royalty rate applicable to post-1972 sound recordings increases. For the remainder of 2016 and in 2017, we expect to recognize \$10,154 and \$43,442, respectively, in expense related to the settlement relating to the use of pre-1972 sound recordings. As determined by the Copyright Royalty Board, we have paid or will pay royalties for the use of certain post-1972 sound recordings on our satellite radio service of 10.0%, 10.5% and 11% in 2015, 2016 and 2017, respectively.

Programming and Content includes costs to acquire, create, promote and produce content. We have entered into various agreements with third parties for music and non-music programming that require us to pay license fees and other amounts.

For the three months ended September 30, 2016 and 2015, programming and content expenses were \$89,015 and \$75,707, respectively, an increase of 18%, or \$13,308, and increased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, programming and content expenses were \$257,760 and \$216,223, respectively, an increase of 19%, or \$41,537, and increased as a percentage of total revenue. The period over period increases were primarily due to renewed programming licenses as well as increased personnel related costs.

We expect our programming and content expenses to increase as we offer additional programming, and renew or replace expiring agreements.

Customer Service and Billing includes costs associated with the operation and management of internal and third party customer service centers, and our subscriber management systems as well as billing and collection costs, bad debt expense, and transaction fees.

For the three months ended September 30, 2016 and 2015, customer service and billing expenses were \$94,923 and \$94,492, respectively, an increase of less than 1%, or \$431, but decreased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, customer services and billing expenses were \$285,502 and \$278,521, respectively, an increase of 3%, or \$6,981, but decreased as a percentage of total revenue. The period over period increases were primarily due to costs associated with a higher subscriber base driving greater bad debt expenses, transaction fees, and call center costs, partially offset by lower personnel related costs and classifying wireless transmission costs related to our connected vehicle services to Satellite and transmission expense in 2016.

We expect our customer service and billing expenses to increase as our subscriber base grows.

Satellite and Transmission consists of costs associated with the operation and maintenance of our terrestrial repeater networks; satellites; satellite telemetry, tracking and control systems; satellite uplink facilities; studios; and delivery of our Internet streaming and connected vehicle services.

For the three months ended September 30, 2016 and 2015, satellite and transmission expenses were \$22,224 and \$22,743, respectively, a decrease of 2%, or \$519, and decreased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, satellite and transmission expenses were \$80,609 and \$65,761, respectively, an increase of 23%, or \$14,848, and increased as a percentage of revenue. The decrease in the three month period was driven primarily by lower web streaming costs from insourcing certain activities and repeater costs, offset by the inclusion of wireless transmission costs related to our connected vehicle services that were previously recorded to Customer service and billing expense in 2015. The increase for the nine month period was primarily due to the loss on disposal of certain obsolete satellite parts of \$12,912, recorded in the three months ended June 30, 2016.

We expect satellite and transmission expenses, net of losses on disposals of assets, to remain relatively flat.

Cost of Equipment includes costs from the sale of satellite radios, components and accessories and provisions for inventory allowance attributable to products purchased for resale in our direct to consumer distribution channels.

For the three months ended September 30, 2016 and 2015, cost of equipment was \$9,674 and \$9,246, respectively, an increase of 5%, or \$428, but decreased as a percentage of equipment revenue. For the nine months ended September 30, 2016 and 2015, cost of equipment was \$29,181 and \$29,021, respectively, an increase of 1%, or \$160, but decreased as a percentage of equipment revenue.

We expect cost of equipment to fluctuate with changes in sales and inventory valuations.

Subscriber Acquisition Costs include hardware subsidies paid to radio manufacturers, distributors and automakers; subsidies paid for chipsets and certain other components used in manufacturing radios; device royalties for certain radios and

chipsets; commissions paid to automakers and retailers; product warranty obligations; freight; and provisions for inventory allowances attributable to inventory consumed in our OEM and retail distribution channels. The majority of subscriber acquisition costs are incurred and expensed in advance of, or concurrent with, acquiring a subscriber. Subscriber acquisition costs do not include advertising costs, marketing, loyalty payments to distributors and dealers of satellite radios or revenue share payments to automakers and retailers of satellite radios.

For the three months ended September 30, 2016 and 2015, subscriber acquisition costs were \$120,111 and \$133,009, respectively, a decrease of 10%, or \$12,898, and decreased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, subscriber acquisition costs were \$381,516 and \$391,773, respectively, a decrease of 3%, or \$10,257, and decreased as a percentage of total revenue. The period over period decrease for the three months ended September 30, 2016 was driven by lower OEM hardware subsidies, a contractual reduction to a subsidy rate, and lower subsidized costs related to the transition of chipsets, partially offset by higher radio installations. The period over period decrease for the nine months ended September 30, 2016 was driven by a contractual reduction to a subsidy rate, and lower subsidized costs related to the transition of chipsets, partially offset by higher radio installations and related OEM hardware subsidies.

We expect subscriber acquisition costs to fluctuate with OEM installations and aftermarket volume; however, the cost of subsidized radio components is expected to decline. We intend to continue to offer subsidies, commissions and other incentives to acquire subscribers.

Sales and Marketing includes costs for marketing, advertising, media and production, including promotional events and sponsorships; cooperative marketing; and personnel. Marketing costs include expenses related to direct mail, outbound telemarketing and email communications.

For the three months ended September 30, 2016 and 2015, sales and marketing expenses were \$99,194 and \$90,541, respectively, an increase of 10%, or \$8,653, and increased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, sales and marketing expenses were \$279,278 and \$255,778, respectively, an increase of 9%, or \$23,500, but decreased as a percentage of total revenue. The period over period increases for the three and nine months ended September 30, 2016 were primarily due to increased subscriber retention and acquisition campaigns related to our subscriber growth as well as higher personnel costs.

We anticipate that sales and marketing expenses will increase as we expand programs to retain our existing subscribers, win back former subscribers and attract new subscribers.

Engineering, Design and Development consists primarily of compensation and related costs to develop chipsets and new products and services, including streaming and connected vehicle services, research and development for broadcast information systems and costs associated with the incorporation of our radios into new vehicles manufactured by automakers.

For the three months ended September 30, 2016 and 2015, engineering, design and development expenses were \$19,254 and \$16,132, respectively, an increase of 19%, or \$3,122, and increased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, engineering, design and development expenses were \$57,588 and \$47,180, respectively, an increase of 22%, or \$10,408, and increased as a percentage of total revenue. The period over period increases for the three and nine months ended September 30, 2016 were driven primarily by the inclusion of personnel related costs from our connected vehicle services that were previously recorded in Sales and marketing and General and administrative expense in 2015, partially offset by lower research and development costs.

We expect engineering, design and development expenses to increase in future periods as we continue to develop our infrastructure, products and services.

General and Administrative primarily consists of compensation and related costs for personnel and facilities, and include costs related to our finance, legal, human resources and information technologies departments.

For the three months ended September 30, 2016 and 2015, general and administrative expenses were \$90,369 and \$67,234, respectively, an increase of 34%, or \$23,135, and increased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, general and administrative expenses were \$249,052 and \$219,194, respectively, an increase of 14%, or \$29,858, and increased as a percentage of total revenue. The period over period increases for the three and nine months ended September 30, 2016 were primarily driven by higher consulting and legal costs. Costs in the three months ended September 30, 2015, benefited from insurance recoveries related to a legal settlement.

We expect our general and administrative expenses to increase in future periods as a result of, among other things, enhanced information technology, on-going legal costs and personnel costs to support the growth of our business.

Depreciation and Amortization represents the recognition in earnings of the cost of assets used in operations, including our satellite constellations, property, equipment and intangible assets, over their estimated service lives.

For the three months ended September 30, 2016 and 2015, depreciation and amortization expense was \$67,880 and \$70,404, respectively, a decrease of 4%, or \$2,524, and decreased as a percentage of total revenue. For the nine months ended September 30, 2016 and 2015, depreciation and amortization expense was \$202,215 and \$202,527, respectively, a decrease of less than 1%, or \$312, and decreased as a percentage of total revenue. The decrease for the three month period was driven by certain satellites and software reaching the end of their estimated lives in 2015, partially offset by additional software and terrestrial repeater assets placed in service.

Other Income (Expense)

Interest Expense includes interest on outstanding debt.

For the three months ended September 30, 2016 and 2015, interest expense was \$89,092 and \$76,624, respectively, an increase of 16%, or \$12,468. For the nine months ended September 30, 2016 and 2015, interest expense was \$250,888 and \$221,912, respectively, an increase of 13%, or \$28,976. The increase was primarily due to higher average debt during the three and nine months ended September 30, 2016 compared to the three and nine months ended September 30, 2015.

We expect interest expense to increase in future periods to the extent our total debt outstanding increases.

Other Income primarily includes realized gains and losses, interest income, and our share of the income or loss of Sirius XM Canada.

For the three months ended September 30, 2016 and 2015, interest and investment income was \$2,370 and \$4,133, respectively. For the nine months ended September 30, 2016 and 2015, interest and investment income was \$15,733 and \$9,077, respectively. The income for the three and nine months ended September 30, 2016 was driven by our share of Sirius XM Canada's net income. The nine months ended September 30, 2016 also included dividends received from Sirius XM Canada in excess of our investment. Pursuant to the Arrangement Agreement, Sirius XM Canada did not pay any dividends during the three months ended September 30, 2016. The income for the three and nine months ended September 30, 2015 was driven by the dividends received from Sirius XM Canada in excess of our investment.

Income Taxes

Income Tax Expense includes the change in our deferred tax assets, foreign withholding taxes and current federal and state tax expenses.

For the three months ended September 30, 2016 and 2015, income tax expense was \$111,556 and \$112,543, respectively. For the nine months ended September 30, 2016 and 2015, income tax expense was \$326,108 and \$296,893, respectively.

Our effective tax rate for the three and nine months ended September 30, 2016 was 36.5% and 37.6%, respectively. We estimate our annual effective tax rate for the year ending December 31, 2016 will be approximately 32% as we expect to recognize a Federal R&D tax credit in the fourth quarter of 2016 relating to the Protecting Americans from Tax Hikes Act of 2015. Our effective tax rate for the three and nine months ended September 30, 2015 was 40.3% and 44.2%, respectively. Our effective tax rate for the nine months ended September 30, 2015 was impacted by tax law changes in the District of Columbia and New York City. The tax law change in the District of Columbia will reduce our future tax and thus we will use less of certain net operating losses in the future which resulted in a \$44,392 increase in our valuation allowance during the three months ended March 31, 2015. The tax law change in New York City will increase certain net operating losses to be utilized in the future which resulted in a \$14,831 increase in our deferred tax asset during the three months ended June 30, 2015.

Key Financial and Operating Performance Metrics

In this section, we present certain financial performance measures that are not calculated and presented in accordance with generally accepted accounting principles in the United States (“Non-GAAP”), which include free cash flow and adjusted EBITDA. We also present certain operating performance measures, which include average monthly revenue per subscriber, or ARPU; customer service and billing expenses, per average subscriber; and subscriber acquisition cost, or SAC, per installation. To the extent applicable, these measures exclude the impact of share-based payment expense and certain purchase price accounting adjustments related to the merger of Sirius and XM (the “Merger”). Additionally, when applicable, our adjusted EBITDA and free cash flow metrics exclude the effect of significant items that do not relate to the on-going performance of our business. We use these Non-GAAP financial and operating performance measures to manage our business, to set operational goals and as a basis for determining performance-based compensation for our employees. See accompanying glossary on pages 37 through 40 for more details and for the reconciliation to the most directly comparable GAAP measure (where applicable).

We believe these Non-GAAP financial and operating performance measures provide useful information to investors regarding our financial condition and results of operations. We believe investors find these Non-GAAP financial and operating performance measures useful in evaluating our core trends because they provide a direct view of our underlying contractual costs. We believe investors use our adjusted EBITDA to estimate our current enterprise value and to make investment decisions. We believe free cash flow provides useful supplemental information to investors regarding our cash available for future subscriber acquisition and capital expenditures, to repurchase or retire debt, to acquire other companies and to evaluate our ability to return capital to stockholders. By providing these Non-GAAP financial and operating performance measures, together with the reconciliations to the most directly comparable GAAP measure (where applicable), we believe we are enhancing investors' understanding of our business and our results of operations.

Our Non-GAAP financial measures should be viewed in addition to, and not as an alternative for or superior to, our reported results prepared in accordance with GAAP. In addition, our Non-GAAP financial measures may not be comparable to similarly-titled measures by other companies. Please refer to the glossary (pages 37 through 40) for a further discussion of such Non-GAAP financial and operating performance measures and reconciliations to the most directly comparable GAAP measure (where applicable). Subscribers and subscription related revenues and expenses associated with our connected vehicle services are not included in our subscriber count or subscriber-based operating metrics.

Set forth below are our subscriber balances as of September 30, 2016 compared to September 30, 2015:

	As of September 30,		2016 vs 2015 Change	
	2016	2015	Amount	%
Self-pay subscribers	25,528	23,816	1,712	7%
Paid promotional subscribers	5,463	5,143	320	6%
Ending subscribers ^(a)	30,991	28,960	2,031	7%

(a) Amounts may not sum as a result of rounding.

The following table contains our Non-GAAP financial and operating performance measures which are based on our adjusted results of operations for the three and nine months ended September 30, 2016 and 2015:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		2016 vs 2015 Change			
	2016	2015	2016	2015	Three Months		Nine Months	
					Amount	%	Amount	%
Self-pay subscribers	385	381	1,240	1,293	4	1 %	(53)	(4)%
Paid promotional subscribers	(39)	145	157	355	(184)	(127)%	(198)	(56)%
Net additions ^(a)	345	525	1,397	1,649	(180)	(34)%	(252)	(15)%
Daily weighted average number of subscribers	30,776	28,649	30,290	28,033	2,127	7 %	2,257	8 %
Average self-pay monthly churn	1.9%	1.9%	1.8%	1.8%	0 %	0 %	0 %	0 %
New vehicle consumer conversion rate	40%	41%	39%	41%	(1)%	(2)%	(2)%	(5)%
ARPU	\$ 13.04	\$ 12.67	\$ 12.83	\$ 12.45	\$ 0.37	3 %	\$ 0.38	3 %
SAC, per installation	\$ 28	\$ 34	\$ 31	\$ 33	\$ (6)	(18)%	\$ (2)	(6)%
Customer service and billing expenses, per average subscriber	\$ 0.97	\$ 1.00	\$ 0.98	\$ 1.00	\$ (0.03)	(3)%	\$ (0.02)	(2)%
Adjusted EBITDA	\$ 491,892	\$ 447,194	\$1,401,024	\$1,261,382	\$ 44,698	10 %	\$ 139,642	11 %
Free cash flow	\$ 356,527	\$ 368,899	\$1,079,690	\$1,016,045	\$ (12,372)	(3)%	\$ 63,645	6 %
Diluted weighted average common shares outstanding (GAAP)	4,919,829	5,346,438	5,005,133	5,487,116	(426,609)	(8)%	(481,983)	(9)%

(a) Amounts may not sum as a result of rounding.

Subscribers. At September 30, 2016, we had approximately 31.0 million subscribers, an increase of 2.0 million subscribers, or 7%, from the approximately 29.0 million subscribers as of September 30, 2015. The increase in total subscribers was primarily due to growth in our self-pay subscriber base, which increased 1.7 million. The increase in self-pay subscribers is primarily from original and subsequent owner trial conversions and subscriber win back programs, partially offset by deactivations. Our increase in paid promotional subscribers of 320 thousand subscribers resulted from the shipment of additional vehicles by OEMs offering paid trials.

For the three months ended September 30, 2016 and 2015, net additions were 345 thousand and 525 thousand, respectively, a decrease of 34%. For the nine months ended September 30, 2016 and 2015, net additions were 1,397 thousand and 1,649 thousand, respectively, a decrease of 15%. The period over period decrease for the three and nine months ended September 30, 2016 was due to a decrease in net additions of paid promotional subscribers as a result of slower growth in vehicle sales. Self-pay net additions increased slightly during the three months ended September 30, 2016 and decreased 4% for the nine months ended September 30, 2016. For the nine months ended September 30, 2016, the decrease in self-pay net additions was due to increases in deactivations from our larger subscriber base which were largely offset by increases in trial conversions and subscriber win back programs.

Average Self-pay Monthly Churn is derived by dividing the monthly average of self-pay deactivations for the period by the average number of self-pay subscribers for the period. (See accompanying glossary on pages 37 through 40 for more details.)

For the three months ended September 30, 2016 and 2015, our average self-pay monthly churn rate was 1.9%. For the nine months ended September 30, 2016 and 2015, our average self-pay monthly churn rate was 1.8%.

New Vehicle Consumer Conversion Rate is the percentage of owners and lessees of new vehicles that receive our service and convert to become self-paying subscribers after an initial promotional period. The metric excludes rental and fleet vehicles. (See accompanying glossary on pages 37 through 40 for more details).

For the three months ended September 30, 2016 and 2015, our new vehicle consumer conversion rate was 40% and 41%, respectively. For the nine months ended September 30, 2016 and 2015, our new vehicle consumer conversion rate was

39% and 41%, respectively. The period over period decrease for the three and nine months ended September 30, 2016 was primarily due to an increased vehicle penetration rate as well as lower conversion of first-time buyers and lessees of satellite radio enabled cars.

ARPU is derived from total earned subscriber revenue (excluding revenue derived from our connected vehicle services), net advertising revenue and other subscription-related revenue, divided by the number of months in the period, divided by the daily weighted average number of subscribers for the period. (See the accompanying glossary on pages 37 through 40 for more details.)

For the three months ended September 30, 2016 and 2015, ARPU was \$13.04 and \$12.67, respectively. For the nine months ended September 30, 2016 and 2015, ARPU was \$12.83 and \$12.45, respectively. The period over period increase for the three and nine months ended September 30, 2016 was driven primarily by increases in certain of our subscription and other subscription related rates, partially offset by growth in subscription discounts offered through customer acquisition and retention programs.

SAC, Per Installation, is derived from subscriber acquisition costs and margins from the sale of radios, components and accessories, divided by the number of satellite radio installations in new vehicles and shipments of aftermarket radios for the period. (See the accompanying glossary on pages 37 through 40 for more details.)

For the three months ended September 30, 2016 and 2015, SAC, per installation, was \$28 and \$34, respectively. For the nine months ended September 30, 2016 and 2015, SAC, per installation, was \$31 and \$33, respectively. The period over period decrease for the three months and nine months ended September 30, 2016 was driven by lower OEM hardware subsidy rates as well as lower subsidized costs related to the transition of chipsets. Additionally, for the three months ended September 30, 2016, subscriber acquisition costs benefited approximately \$2.00 per installation from a contractual reduction to a subsidy rate.

Customer Service and Billing Expenses, Per Average Subscriber, is derived from total customer service and billing expenses, excluding connected vehicle customer service and billing expenses and share-based payment expense, divided by the number of months in the period, divided by the daily weighted average number of subscribers for the period. (See the accompanying glossary on pages 37 through 40 for more details.)

For the three months ended September 30, 2016 and 2015, customer service and billing expenses, per average subscriber, was \$0.97 and \$1.00, respectively. For the nine months ended September 30, 2016 and 2015, customer service and billing expenses, per average subscriber, was \$0.98 and \$1.00, respectively. The period over period decrease for the three months and nine months ended September 30, 2016 was primarily related to efficiencies achieved from call center process enhancements and lower personnel related costs, partially offset by increased bad debt expense and transaction fees per subscriber.

Adjusted EBITDA. EBITDA is defined as net income before interest expense, income tax expense and depreciation and amortization. Adjusted EBITDA excludes the impact of other income other non-cash charges, such as certain purchase price accounting adjustments, share-based payment expense, and loss on disposal of assets and settlements related to the historical use of pre-1972 sound recordings. (See the accompanying glossary on pages 37 through 40 for a reconciliation to GAAP and for more details.)

For the three months ended September 30, 2016 and 2015, adjusted EBITDA was \$491,892 and \$447,194, respectively, an increase of 10%, or \$44,698. For the nine months ended September 30, 2016 and 2015, adjusted EBITDA was \$1,401,024 and \$1,261,382, respectively, an increase of 11%, or \$139,642. The increase was due to growth in revenues primarily as a result of the increase in our subscriber base and certain of our subscription rates, partially offset by higher revenue share and royalties costs due to growth in our revenues, higher programming and content costs associated with renewed agreements, higher sales and marketing costs associated with growth in our subscriber base, and higher general and administrative costs.

Free Cash Flow includes cash provided by operations, net of additions to property and equipment, and restricted and other investment activity and excluding the \$210,000 pre-1972 sound recordings legal settlement payment made in 2015. (See the accompanying glossary on pages 37 through 40 for a reconciliation to GAAP and for more details.)

For the three months ended September 30, 2016 and 2015, free cash flow was \$356,527 and \$368,899, respectively, a decrease of \$12,372, or 3%. For the nine months ended September 30, 2016 and 2015, free cash flow was \$1,079,690 and \$1,016,045, respectively, an increase of \$63,645 or 6%. The decrease for the three month period ended September 30, 2016 was driven by additions to property and equipment resulting primarily from new satellite construction, and a payment of approximately \$22,400, net of insurance recoveries, in connection with the settlement of class action suits

alleging violations of the Telephone Consumer Protection Act of 1991, partially offset by higher net cash provided by operating activities. The increase for the nine month period ended September 30, 2016 was primarily driven by higher net cash provided by operating activities resulting from higher collections from subscribers; partially offset by an increase in additions to property and equipment resulting primarily from new satellite construction and the payment of approximately \$22,400, net of insurance recoveries, in connection with the settlement of class action suits alleging violations of the Telephone Consumer Protection Act of 1991.

Liquidity and Capital Resources

Cash Flows for the nine months ended September 30, 2016 compared with the nine months ended September 30, 2015

The following table presents a summary of our cash flow activity for the periods set forth below:

	For the Nine Months Ended September 30,		
	2016	2015	2016 vs 2015
Net cash provided by operating activities	\$ 1,183,849	\$ 861,591	\$ 322,258
Net cash used in investing activities	(136,414)	(94,909)	(41,505)
Net cash used in financing activities	(586,891)	(761,861)	174,970
Net increase in cash and cash equivalents	460,544	4,821	455,723
Cash and cash equivalents at beginning of period	111,838	147,724	(35,886)
Cash and cash equivalents at end of period	<u>\$ 572,382</u>	<u>\$ 152,545</u>	<u>\$ 419,837</u>

Cash Flows Provided by Operating Activities

Cash flows provided by operating activities increased by \$322,258 to \$1,183,849 for the nine months ended September 30, 2016 from \$861,591 for the nine months ended September 30, 2015.

Our largest source of cash provided by operating activities is generated by subscription and subscription-related revenues. We also generate cash from the sale of advertising on certain non-music channels and the sale of satellite radios, components and accessories. Our primary uses of cash from operating activities include revenue share and royalty payments to distributors, programming and content providers, and payments to radio manufacturers, distributors and automakers. In addition, uses of cash from operating activities include payments to vendors to service, maintain and acquire subscribers, general corporate expenditures, and compensation and related costs.

Cash Flows Used in Investing Activities

Cash flows used in investing activities are primarily additional spending to construct replacement satellites, improve our terrestrial repeater network and for capitalized software. In 2015, our cash flows used in investing activities also included an increase to our letters of credit issued for the benefit of lessors of certain of our office space.

Cash Flows Used in Financing Activities

Cash flows used in financing activities consists of the issuance and repayment of long-term debt and the purchase of common stock under Holdings' share repurchase program. Proceeds from long-term debt, related party debt and equity issuances have been used to fund our operations, construct and launch new satellites and invest in other infrastructure improvements.

Cash flows provided by financing activities in the nine months ended September 30, 2016 were due to the issuance of \$1,000,000 aggregate principal amount of 5.375% Senior Notes due 2026 and borrowings under the Credit Facility. Cash flows used in financing activities in the nine months ended September 30, 2016 were primarily due to the purchase and retirement of shares of Holdings' common stock under Holdings' repurchase program for \$1,225,284 and repayments of borrowings under the Credit Facility. Cash flows provided by financing activities in the nine months ended September 30, 2015 were due to the issuance of \$1,000,000 aggregate principal amount of 5.375% Senior Notes due 2025 and borrowings under the Credit Facility. Cash flows used in financing activities in the nine months ended September 30, 2015 were primarily due to the purchase and retirement of shares of Holdings' common stock under Holdings' repurchase program for \$1,647,728 and repayments of borrowings under the Credit Facility.

Future Liquidity and Capital Resource Requirements

Based upon our current business plans, we expect to fund operating expenses, capital expenditures, including the construction of replacement satellites, working capital requirements, legal settlements, interest payments, taxes and scheduled maturities of our debt with existing cash, cash flow from operations and borrowings under our Credit Facility. As of September 30, 2016, \$1,750,000 was available for future borrowing under our Credit Facility. On October 3, 2016, we redeemed \$650,000 in principal amount of our outstanding 5.875% Notes for an approximate purchase price of \$669,097, including premium. This redemption was funded with \$359,097 of Cash and cash equivalents and \$310,000 of borrowings under our Credit Facility. We believe that we have sufficient cash and cash equivalents as well as debt capacity to cover our estimated short-term and long-term funding needs, as well as fund stock repurchases and strategic opportunities.

Our ability to meet our debt and other obligations depends on our future operating performance and on economic, financial, competitive and other factors. We continually review our operations for opportunities to adjust the timing of expenditures to ensure that sufficient resources are maintained.

We regularly evaluate our business plans and strategy. These evaluations often result in changes to our business plans and strategy, some of which may be material and significantly change our cash requirements. These changes in our business plans or strategy may include: the acquisition of unique or compelling programming; the development and introduction of new features or services; significant new or enhanced distribution arrangements; investments in infrastructure, such as satellites, equipment or radio spectrum; and acquisitions, including acquisitions that are not directly related to our satellite radio business.

Holdings' Capital Return Program

As of September 30, 2016, Holdings' board of directors had approved for repurchase an aggregate of \$8,000,000 of Holdings common stock. As of September 30, 2016, Holdings' cumulative repurchases since December 2012 totaled \$7,515,223, and \$484,777 remained available under Holdings' stock repurchase program.

On October 26, 2016, Holdings' board of directors approved an additional \$2,000,000 for repurchase of Holdings' common stock. The new approval increases the amount of common stock that we have been authorized to repurchase to an aggregate of \$10,000,000. Shares of Holdings' common stock may be purchased from time to time on the open market and in privately negotiated transactions, including in accelerated stock repurchase transactions and transactions with Liberty Media and its affiliates. We intend to fund the additional repurchases of Holdings' common stock through a combination of cash on hand, cash generated by operations and future borrowings.

On October 26, 2016, Holdings' board of directors also declared the first quarterly dividend on Holdings' common stock in the amount of \$0.01 per share of common stock payable on November 30, 2016 to stockholders of record as of the close of business on November 9, 2016. Holdings' board of directors expects that this dividend will be the first of regular quarterly dividends, in an aggregate annual amount of \$0.04 per share of common stock.

Debt Covenants

The indentures governing our senior notes, and the agreement governing the Credit Facility include restrictive covenants. As of September 30, 2016, we were in compliance with such covenants. For a discussion of our "Debt Covenants," refer to Note 9 to our unaudited consolidated financial statements in this Quarterly Report.

Off-Balance Sheet Arrangements

We do not have any significant off-balance sheet arrangements other than those disclosed in Note 12 to our unaudited consolidated financial statements in this Quarterly Report that are reasonably likely to have a material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Contractual Cash Commitments

For a discussion of our "Contractual Cash Commitments," refer to Note 12 to our unaudited consolidated financial statements in this Quarterly Report.

Related Party Transactions

For a discussion of "Related Party Transactions," refer to Note 8 to our unaudited consolidated financial statements in this Quarterly Report.

Critical Accounting Policies and Estimates

For a discussion of our “Critical Accounting Policies and Estimates,” refer to “Management's Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report for the year ended December 31, 2015. There have been no material changes to our critical accounting policies and estimates since December 31, 2015.

Glossary

Adjusted EBITDA - EBITDA is defined as net income before interest expense, income tax expense and depreciation and amortization. We adjust EBITDA to exclude the impact of other income as well as certain other charges discussed below. Adjusted EBITDA is one of the primary Non-GAAP financial measures we use to (i) evaluate the performance of our on-going core operating results period over period, (ii) base our internal budgets and (iii) compensate management. Adjusted EBITDA is a Non-GAAP financial measure that excludes (if applicable): (i) certain adjustments as a result of the purchase price accounting for the Merger, (ii) share-based payment expense and (iii) other significant operating expense (income) that do not relate to the on-going performance of our business. We believe adjusted EBITDA is a useful measure of the underlying trend of our operating performance, which provides useful information about our business apart from the costs associated with our capital structure and purchase price accounting. We believe investors find this Non-GAAP financial measure useful when analyzing our results and comparing our operating performance to the performance of other communications, entertainment and media companies. We believe investors use adjusted EBITDA to estimate our current enterprise value and to make investment decisions. Because of large capital investments in our satellite radio system our results of operations reflect significant charges for depreciation expense. We believe the exclusion of share-based payment expense is useful as it is not directly related to the operational conditions of our business. We also believe the exclusion of settlements related to the historical use of pre-1972 sound recordings and loss on disposal of assets is useful as it does not represent an expense incurred as part of our normal operations for the period.

Adjusted EBITDA has certain limitations in that it does not take into account the impact to our statements of comprehensive income of certain expenses, including share-based payment expense and certain purchase price accounting for the Merger. We endeavor to compensate for the limitations of the Non-GAAP measure presented by also providing the comparable GAAP measure with equal or greater prominence and descriptions of the reconciling items, including quantifying such items, to derive the Non-GAAP measure. Investors that wish to compare and evaluate our operating results after giving effect for these costs, should refer to net income as disclosed in our unaudited consolidated statements of comprehensive income. Since adjusted EBITDA is a Non-GAAP financial performance measure, our calculation of adjusted EBITDA may be susceptible to varying calculations; may not be comparable to other similarly titled measures of other companies; and should not be considered in isolation, as a substitute for, or superior to measures of financial performance prepared in accordance with GAAP. The reconciliation of net income to the adjusted EBITDA is calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income:	\$ 193,901	\$ 166,550	\$ 541,306	\$ 375,091
Add back items excluded from Adjusted EBITDA:				
Purchase price accounting adjustments:				
Revenues	1,813	1,813	5,438	5,438
Operating expenses	—	—	—	(1,394)
Pre-1972 sounds recordings legal settlements	—	—	—	107,658
Loss on disposal of assets	—	—	12,912	—
Share-based payment expense	30,020	23,393	77,890	62,334
Depreciation and amortization	67,880	70,404	202,215	202,527
Interest expense	89,092	76,624	250,888	221,912
Other income	(2,370)	(4,133)	(15,733)	(9,077)
Income tax expense	111,556	112,543	326,108	296,893
Adjusted EBITDA	<u>\$ 491,892</u>	<u>\$ 447,194</u>	<u>\$ 1,401,024</u>	<u>\$ 1,261,382</u>

ARPU - is derived from total earned subscriber revenue, advertising revenue and other subscription-related revenue, excluding revenue associated with our connected vehicle services, divided by the number of months in the period, divided by the daily weighted average number of subscribers for the period. Other subscription-related revenue includes the U.S. Music Royalty Fee. ARPU is calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Subscriber revenue, excluding connected vehicle	\$ 1,048,033	\$ 949,301	\$ 3,044,438	\$ 2,752,993
Add: advertising revenue	34,268	33,131	99,330	88,843
Add: other subscription-related revenue	122,013	106,483	353,606	299,437
	<u>\$ 1,204,314</u>	<u>\$ 1,088,915</u>	<u>\$ 3,497,374</u>	<u>\$ 3,141,273</u>
Daily weighted average number of subscribers	<u>30,776</u>	<u>28,649</u>	<u>30,290</u>	<u>28,033</u>
ARPU	<u>\$ 13.04</u>	<u>\$ 12.67</u>	<u>\$ 12.83</u>	<u>\$ 12.45</u>

Average self-pay monthly churn - is defined as the monthly average of self-pay deactivations for the period divided by the average number of self-pay subscribers for the period.

Customer service and billing expenses, per average subscriber - is derived from total customer service and billing expenses, excluding connected vehicle customer service and billing expenses and share-based payment expense, divided by the number of months in the period, divided by the daily weighted average number of subscribers for the period. We believe the exclusion of share-based payment expense in our calculation of customer service and billing expenses, per average subscriber, is useful as share-based payment expense is not directly related to the operational conditions that give rise to variations in the components of our customer service and billing expenses. Customer service and billing expenses, per average subscriber, is calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Customer service and billing expenses, excluding connected vehicle	\$ 90,582	\$ 86,840	\$ 270,964	\$ 255,105
Less: share-based payment expense	(1,069)	(793)	(2,694)	(2,164)
	<u>\$ 89,513</u>	<u>\$ 86,047</u>	<u>\$ 268,270</u>	<u>\$ 252,941</u>
Daily weighted average number of subscribers	<u>30,776</u>	<u>28,649</u>	<u>30,290</u>	<u>28,033</u>
Customer service and billing expenses, per average subscriber	<u>\$ 0.97</u>	<u>\$ 1.00</u>	<u>\$ 0.98</u>	<u>\$ 1.00</u>

Free cash flow - is derived from cash flow provided by operating activities, net of additions to property and equipment, restricted and other investment activity and the return of capital from investment in unconsolidated entity. Free cash flow is a metric that our management and board of directors use to evaluate the cash generated by our operations, net of capital expenditures and other investment activity and significant items that do not relate to the on-going performance of our business. In a capital intensive business, with significant investments in satellites, we look at our operating cash flow, net of these investing cash outflows, to determine cash available for future subscriber acquisition and capital expenditures, to repurchase or retire debt, to acquire other companies and to evaluate our ability to return capital to stockholders. We believe free cash flow is an indicator of the long-term financial stability of our business. Free cash flow, which is reconciled to “Net cash provided by operating activities,” is a Non-GAAP financial measure. This measure can be calculated by deducting amounts under the captions “Additions to property and equipment” and deducting or adding Restricted and other investment activity from “Net cash provided by operating activities” from the unaudited consolidated statements of cash flows, adjusted for any significant legal settlements. We have excluded the \$210,000 payment related to the pre-1972 sound recordings legal settlement from our free cash flow calculation in the three and nine months ended September 30, 2015. Free cash flow should be used in conjunction with other GAAP financial performance measures and may not be comparable to free cash flow measures presented by other companies. Free cash flow should be viewed as a supplemental measure rather than an alternative measure of cash flows from operating activities, as determined in accordance with GAAP. Free cash flow is limited and does not represent remaining cash flows available for discretionary expenditures due to the fact that the measure does not deduct the payments required for debt maturities. We believe free cash flow provides useful supplemental information to investors regarding our current cash flow, along with other GAAP measures (such as cash flows from operating and investing activities), to determine our financial condition, and to compare our operating performance to other communications, entertainment and media companies. Free cash flow is calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Cash Flow information				
Net cash provided by operating activities	\$ 394,940	\$ 164,670	\$ 1,183,849	\$ 861,591
Net cash used in investing activities	\$ (65,289)	\$ (29,714)	\$ (136,414)	\$ (94,909)
Net cash used in financing activities	\$ (233,722)	\$ (276,464)	\$ (586,891)	\$ (761,861)
Free Cash Flow				
Net cash provided by operating activities	\$ 394,940	\$ 164,670	\$ 1,183,849	\$ 861,591
Equity-related transactions for Holdings ^(a)	26,876	23,943	32,255	39,363
Additions to property and equipment	(65,074)	(29,714)	(132,246)	(90,943)
Purchases of restricted and other investments	(215)	—	(4,168)	(3,966)
Pre-1972 sound recordings legal settlement	—	210,000	—	210,000
Free cash flow	<u>\$ 356,527</u>	<u>\$ 368,899</u>	<u>\$ 1,079,690</u>	<u>\$ 1,016,045</u>

- (a) Subsequent to our corporate reorganization effective November 15, 2013, all equity-related transactions are reported as related party transactions within Sirius XM's consolidated financial statements. For the nine months ended September 30, 2016 and 2015, this included payments of \$32,603 and \$39,622, respectively for taxes paid in lieu of shares issued for stock-based compensation and \$348 and \$259, respectively, in proceeds from the exercise of stock options. These equity-related transactions are classified as Cash flows provided by financing activities within Holdings' unaudited consolidated statements of cash flows, and therefore, are adjusted to reflect free cash flow at Sirius XM.

New vehicle consumer conversion rate - is defined as the percentage of owners and lessees of new vehicles that receive our satellite radio service and convert to become self-paying subscribers after the initial promotion period. At the time satellite radio enabled vehicles are sold or leased, the owners or lessees generally receive trial subscriptions ranging from three to twelve months. We measure conversion rate three months after the period in which the trial service ends. The metric excludes rental and fleet vehicles.

Subscriber acquisition cost, per installation - or SAC, per installation, is derived from subscriber acquisition costs and margins from the sale of radios and accessories, divided by the number of satellite radio installations in new vehicles and shipments of aftermarket radios for the period. SAC, per installation, is calculated as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Subscriber acquisition costs	\$ 120,111	\$ 133,009	\$ 381,516	\$ 391,773
Less: margin from sales of radios and accessories	(21,632)	(16,629)	(57,104)	(50,958)
	\$ 98,479	\$ 116,380	\$ 324,412	\$ 340,815
Installations	3,498	3,429	10,404	10,305
SAC, per installation	\$ 28	\$ 34	\$ 31	\$ 33