

COVER STORY

Satellite Radio: Great Product What About the Business Model?

by Howard Greenfield

“I’m a fan of the technology and the subscription model. There’s a bright future for them, but it may be a long time before that future manifests itself.”

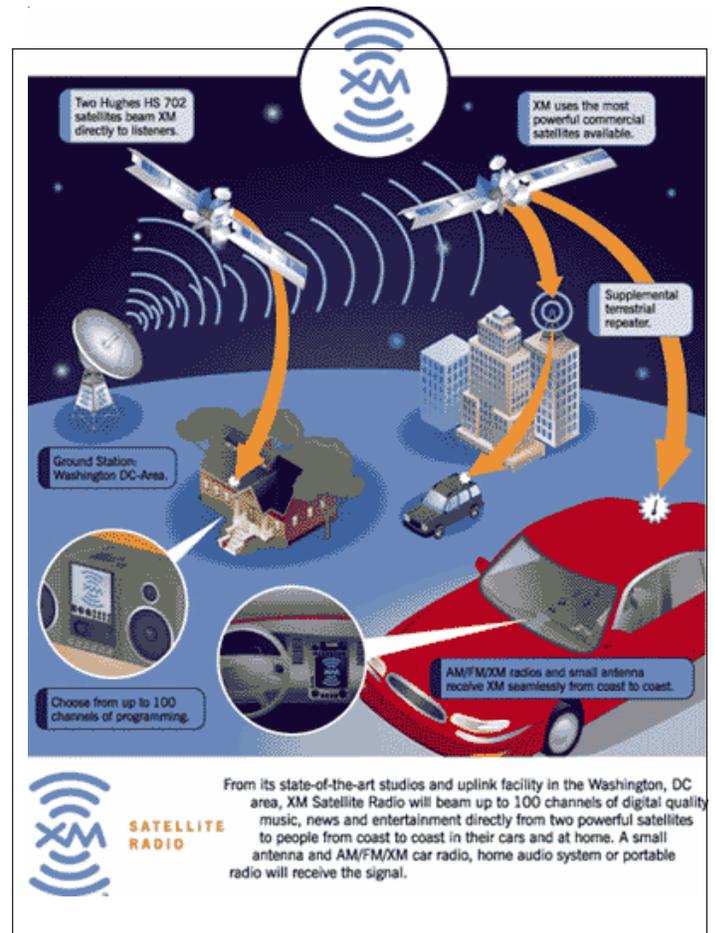
—Peter S. Fader, Wharton School

Growth and Speculation

Is satellite radio poised to overtake traditional broadcast business? Or will it falter from growth it can’t sustain and competition it can’t forsee? 2004 subscriber figures are inconclusive but encouraging. Industry leaders Sirius and XM are growing but projected profitability is dependant on the steady ramp of a new, paying audience. Though there has been speculation the two might merge, perhaps bypassing growth speed bumps, company executives deny the rumors. “I have no idea where any of this came from” responded XM CEO Mel Karmazin recently.

Currently XM has over 3.2 million subscribers (up 1.8 million subscribers from January, 2004), and Sirius exceeded 1 million subscribers. However, some say the growth curve to success is a dream. Even though neither is yet profitable, together they have a staggering multi-billion dollar valuation. Many analysts, believing shares are too expensive, question the nature of the financial picture—even using the “b” word (bubble). Others see a trade-off in such kick-start efforts as subscriber and equipment discounting: “Yes, it is a problem, because whenever you take funds out of the cycle, it affects profitability, at least in the short term. On the other hand, the Holy Grail for both Sirius and XM these days is gaining new subscribers; so many sacrifices will be made in order to achieve that long term goal. It’s pretty basic.” says The Carmel Group’s Jimmy Schaeffler.

“It’s a gamble based on market potential” acknowledges Sirius’ Jim Collins who adds “the service has a high pleasure quotient and our churn rates are low with crystal clear signal programmed by creative staff—it’s living, breathing and it’s infectious.” He also points to motor vehicle potential uptake as another metric. Sirius announced this year that Ford and Lincoln Mercury will begin offering SIRIUS as a factory installed option this summer in 21 vehicle lines and believe they will generate up



to one million SIRIUS subscribers over the 2006 and 2007 model year periods. “It’s a huge market, and even with a fraction we’re [Sirius and XM] both going to make it”.

An Infectious Service

You can’t knock Satellite Radio service: 130 channels of clear programming—often commercial-free. Customers gush about the quantity and quality: “unbelievable sound quality and selection” submitting “it now makes me want to spend more time in traffic and even take the long way home—it’s that good.”

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While most terrestrial signals drop out after 30 or 40 miles, satellite radio is broadcast from over 20,000 miles above the earth so radio reception is uniform across thousands of miles. Like cable's effect on television, Satellite Radio is offering richer choices of content.

The signs of growth follow huge industry investment to create such an "infectious" service in satellite infrastructure. Other recent developments are helping build the industry:

Shock Jock: Howard Stern will move to Sirius in January 2006 (and will receive a salary of \$1M / year for the next five years)

Car deals: Daimler-Chrysler and General Motors have each invested over \$100M respectively in SIRIUS and XM. Honda will use XM radios in their cars and late last year, Toyota also said it would be providing XM capabilities to its vehicles—factory installed by 2006.

Sports!: XM has announced an 11-year, \$650 million deal with Major League Baseball, indicating they could broadcast games of every Major League Baseball (MLB) team from the 2005 season. On February 15th, XM also unveiled a 24-hour MLB-only station.

Other attractions are new digital devices with iPod and TiVo-like functionality, MP3/CD compatibility, and real-time traffic service. At the CES (Consumer Electronics Show) in January,



The new Delphi handheld Satellite Radio for XM

Sirius introduced the Star Mate, a transportable radio unit nearly the size of a deck of cards. Only six ounces, it accesses 120 channels for plug and play in home, vehicle or boat. The Delphi XM MyFi™ is also a great persuader. With re-chargeable battery, it can store up to five hours of audio, and can wirelessly transmit to any FM radio speaker system, car, home or portable.

Because the industry is currently technology agnostic, many additional combinations of features and platforms are bound to materialize. The direction may be unpredictable, but commercial potential and pace of consumer electronics assures we'll be seeing many new form factors.

Other industry growth factors include:

Replacements: As ABI Research reports, millions of radios will need to be replaced (incentive for hardware and component industry sector)

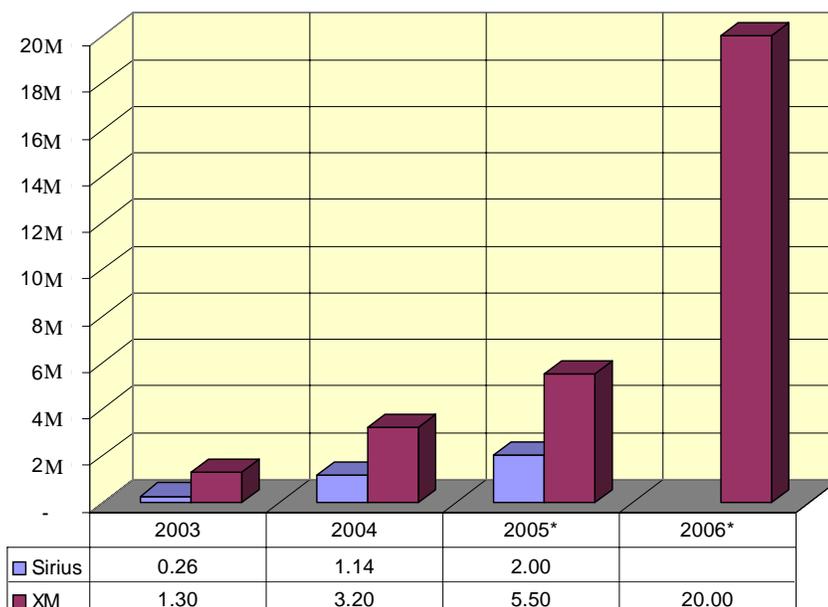
'Cheaper, Better': Satellite radio technology is more cost effective due to the economics of falling electronics costs and better use of channels – more spectrum, and more services.

The Business Model

With these factors in mind, which direction is the industry headed? Valuations and upside are questioned by some, stocks called over-heated, but there is no crystal ball. As Mark Glaser's Glaser Online offers: "It's a ripe moment for radio. Several trends are converging: digital audio production tools are cheap and accessible; new distribution paths like streaming, satellite radio, digital broadcast radio, wireless and 'podcasting' are emerging" (Jake Shapiro, executive director of PRX online content exchange).

So, over-heated or not, sustained growth, widening content, service features, and strategic

SATELLITE RADIO SUBSCRIBERS 2003 - 2006



* Projected Source: XM and Sirius.

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deals make the future appear to be sound. As XM's Chance Patterson puts it, the only stumbling block is "awareness - once people become familiar with what we offer then there is a high likelihood that they will become subscribers."



Sirius' Chairman Joe Clayton

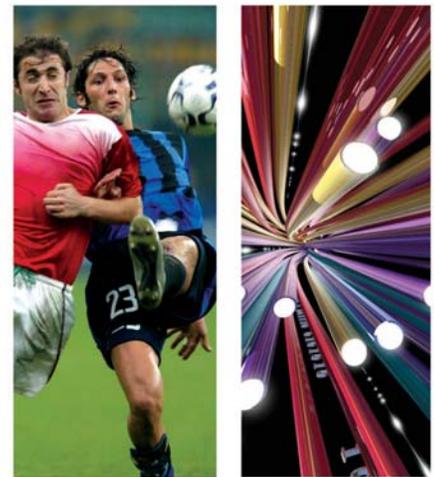
And Sirius' Chairman Joe Clayton opines: "awareness has grown tremendously this past year. This is a subscription driven business, so subscriber numbers are the key to success in this industry. With more auto makers installing satellite radios, and growing popularity of the products in the retail market, we believe that the category will continue to experience strong growth."

For now, even industry observers don't dispute the momentum. The Carmel Group's Jimmy Schaeffler proclaimed earlier on that "Satellite Radio will succeed. Period." He sums it up well: "the business model is wide open and receptive to all kinds of innovation. They have to be: this is fresh ground, there's no model for this stuff. Exciting, risky—but tons of reasons why it will make it (even though looking at its aggregate \$8B valuation is nuts). Bottom line is they're going to prevail. I don't have any doubt about it at all" **SM**

Howard Greenfield is a freelance writer who has held leadership roles in top Fortune 1000, Silicon Valley, and European companies including Sun Microsystems, Informix Software, Apple Computer, and British Telecom. He is principal of Go Associates, a leading consultancy that develops and implements high-tech product marketing and business development strategies. Howard also currently serves on the board of BlueVoice, a nonprofit marine life preservation organization. He can be reached at howard@go-associates.com.



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