
SIRIUS XM RADIO INC.

(Exact name of company as specified in its charter)

QUARTERLY REPORT

For the Quarterly Period Ended June 30, 2018

Explanatory Note

Sirius XM Radio Inc. ("Sirius XM") is furnishing this Quarterly Report for the quarterly period ended June 30, 2018 (the "Quarterly Report") in order to comply with the reporting obligations in the indentures governing its 3.875% Senior Notes due 2022, 4.625% Senior Notes due 2023, 6.00% Senior Notes due 2024, 5.375% Senior Notes due 2025, 5.375% Senior Notes due 2026 and 5.00% Senior Notes due 2027 (collectively, the "Notes").

Before making any investment decisions in Sirius XM or Sirius XM Holdings Inc. ("Holdings"), investors should read the following unaudited 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 June 30, 2018 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 June 30, 2018 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 June 30, | | For the Six Months Ended June 30, | |
|--|--|--------------|--|--------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue: | | | | |
| Subscriber revenue | \$ 1,138,962 | \$ 1,111,011 | \$ 2,256,046 | \$ 2,189,268 |
| Advertising revenue | 47,242 | 40,178 | 89,290 | 76,194 |
| Equipment revenue | 36,840 | 29,674 | 71,929 | 59,332 |
| Music royalty fee and other revenue | 209,255 | 166,706 | 390,136 | 316,841 |
| Total revenue | 1,432,299 | 1,347,569 | 2,807,401 | 2,641,635 |
| Operating expenses: | | | | |
| Cost of services: | | | | |
| Revenue share and royalties | 404,284 | 292,893 | 714,416 | 570,193 |
| Programming and content | 105,650 | 96,255 | 206,486 | 191,799 |
| Customer service and billing | 95,582 | 95,324 | 189,447 | 192,099 |
| Satellite and transmission | 23,478 | 19,603 | 46,200 | 40,179 |
| Cost of equipment | 7,674 | 9,371 | 14,771 | 16,283 |
| Subscriber acquisition costs | 119,778 | 125,154 | 242,471 | 252,642 |
| Sales and marketing | 119,435 | 106,707 | 226,146 | 203,616 |
| Engineering, design and development | 27,485 | 27,783 | 58,122 | 51,600 |
| General and administrative | 92,683 | 84,607 | 177,289 | 162,808 |
| Depreciation and amortization | 74,623 | 73,519 | 146,835 | 150,223 |
| Total operating expenses | 1,070,672 | 931,216 | 2,022,183 | 1,831,442 |
| Income from operations | 361,627 | 416,353 | 785,218 | 810,193 |
| Other income (expense): | | | | |
| Interest expense | (86,917) | (82,794) | (176,706) | (164,451) |
| Other income (expense) | 88,212 | (11,937) | 124,100 | (3,074) |
| Total other income (expense) | 1,295 | (94,731) | (52,606) | (167,525) |
| Income before income taxes | 362,922 | 321,622 | 732,612 | 642,668 |
| Income tax expense | (70,570) | (119,513) | (150,819) | (233,486) |
| Net income attributable to Sirius XM Radio Inc.'s sole stockholder | \$ 292,352 | \$ 202,109 | \$ 581,793 | \$ 409,182 |
| Foreign currency translation adjustment, net of tax | (8,242) | 2,763 | (17,826) | 2,746 |
| Total comprehensive income attributable to Sirius XM Radio Inc.'s sole stockholder | \$ 284,110 | \$ 204,872 | \$ 563,967 | \$ 411,928 |

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)

| | June 30, 2018 (unaudited) | December 31, 2017 |
|---|------------------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 63,516 | \$ 69,022 |
| Receivables, net | 247,148 | 241,727 |
| Inventory, net | 18,967 | 20,199 |
| Related party current assets | 13,692 | 10,284 |
| Prepaid expenses and other current assets | 138,015 | 129,669 |
| Total current assets | 481,338 | 470,901 |
| Property and equipment, net | 1,468,930 | 1,462,766 |
| Intangible assets, net | 2,511,121 | 2,522,846 |
| Goodwill | 2,286,582 | 2,286,582 |
| Related party long-term assets | 8,028,101 | 7,522,007 |
| Deferred tax assets | 371,303 | 505,528 |
| Other long-term assets | 128,543 | 118,671 |
| Total assets | \$ 15,275,918 | \$ 14,889,301 |
| LIABILITIES AND STOCKHOLDER EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 832,869 | \$ 768,077 |
| Accrued interest | 128,029 | 137,428 |
| Current portion of deferred revenue | 1,935,326 | 1,881,825 |
| Current maturities of long-term debt | 4,660 | 5,105 |
| Related party current liabilities | 4,103 | 2,839 |
| Total current liabilities | 2,904,987 | 2,795,274 |
| Deferred revenue | 160,286 | 174,579 |
| Long-term debt | 6,443,289 | 6,741,243 |
| Related party long-term liabilities | 6,269 | 7,364 |
| Deferred tax liabilities | 8,169 | 8,169 |
| Other long-term liabilities | 108,218 | 100,355 |
| Total liabilities | 9,631,218 | 9,826,984 |
| Commitments and contingencies (Note 13) | | |
| Stockholder equity: | | |
| Common stock, par value \$0.001; 9,000,000 shares authorized; 1 share issued and outstanding at June 30, 2018 and December 31, 2017, respectively | — | — |
| Accumulated other comprehensive income, net of tax | 4,594 | 18,407 |
| Additional paid-in capital | 8,679,538 | 8,679,538 |
| Accumulated deficit | (3,039,432) | (3,635,628) |
| Total stockholder equity | 5,644,700 | 5,062,317 |
| Total liabilities and stockholder equity | \$ 15,275,918 | \$ 14,889,301 |

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)

| | Common Stock | | Accumulated Other Comprehensive Income (Loss) | Additional Paid-in Capital | Accumulated Deficit | Total Stockholder Equity |
|--|--------------|--------|--|----------------------------------|------------------------|--------------------------------|
| | Shares | Amount | | | | |
| <i>(in thousands)</i> | | | | | | |
| Balance at December 31, 2017 | 1 | \$ — | \$ 18,407 | \$ 8,679,538 | \$ (3,635,628) | \$ 5,062,317 |
| Cumulative effect of change in accounting principles | — | — | 4,013 | — | 14,403 | 18,416 |
| Comprehensive income, net of tax | — | — | (17,826) | — | 581,793 | 563,967 |
| Balance at June 30, 2018 | 1 | \$ — | \$ 4,594 | \$ 8,679,538 | \$ (3,039,432) | \$ 5,644,700 |

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)

| | For the Six Months Ended June 30, | |
|---|-----------------------------------|------------|
| | 2018 | 2017 |
| <i>(in thousands)</i> | | |
| Cash flows from operating activities: | | |
| Net income | \$ 581,793 | \$ 409,182 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 146,835 | 150,223 |
| Non-cash interest expense, net of amortization of premium | 4,713 | 4,231 |
| Provision for doubtful accounts | 23,944 | 27,377 |
| Amortization of deferred income related to equity method investment | (1,388) | (1,388) |
| Loss on unconsolidated entity investments, net | 64 | 2,183 |
| Gain on fair value instrument | (117,449) | — |
| Dividend received from unconsolidated entity investment | 1,366 | 3,606 |
| Share-based payment expense | 70,448 | 59,697 |
| Deferred income taxes | 134,044 | 220,415 |
| Changes in operating assets and liabilities: | | |
| Receivables | (29,364) | (38,063) |
| Inventory | 1,232 | 2,492 |
| Related party, net | (43,868) | (12,928) |
| Prepaid expenses and other current assets | (177) | (6,617) |
| Other long-term assets | 8,356 | 5,937 |
| Accounts payable and accrued expenses | 58,502 | (84,501) |
| Accrued interest | (9,399) | (7,042) |
| Deferred revenue | 85,100 | 30,779 |
| Other long-term liabilities | 7,863 | 4,358 |
| Net cash provided by operating activities | 922,615 | 769,941 |
| Cash flows from investing activities: | | |
| Additions to property and equipment | (174,273) | (119,517) |
| Purchases of other investments | (7,138) | (7,355) |
| Acquisition of business, net of cash acquired | — | (107,056) |
| Investments in related parties and other equity investees | (6,138) | (302,526) |
| Repayment from (loan to) related party | 3,242 | (130,794) |
| Net cash used in investing activities | (184,307) | (667,248) |
| Cash flows from financing activities: | | |
| Intercompany financing activities | (432,899) | (877,462) |
| Revolving credit facility, net of deferred financing costs | (302,611) | 610,000 |
| Principal payments of long-term borrowings | (7,717) | (6,000) |
| Net cash used in financing activities | (743,227) | (273,462) |
| Net decrease in cash, cash equivalents and restricted cash | (4,919) | (170,769) |
| Cash, cash equivalents and restricted cash at beginning of period | 79,374 | 223,828 |
| Cash, cash equivalents and restricted cash at end of period ⁽¹⁾ | \$ 74,455 | \$ 53,059 |

- (1) The following table reconciles cash, cash equivalents and restricted cash per the statement of cash flows to the balance sheet. The restricted cash balances are primarily due to letters of credit which have been issued to the landlords of leased office space. The terms of the letters of credit primarily extend beyond one year.

| | June 30, 2018 | December 31, 2017 | June 30, 2017 | December 31, 2016 |
|---|---------------|-------------------|---------------|-------------------|
| Cash and cash equivalents | \$ 63,516 | \$ 69,022 | \$ 42,738 | \$ 213,939 |
| Restricted cash included in Prepaid expenses and other current assets | 150 | 244 | 432 | — |
| Restricted cash included in Other long-term assets | 10,789 | 10,108 | 9,889 | 9,889 |
| Total cash, cash equivalents and restricted cash at end of period | \$ 74,455 | \$ 79,374 | \$ 53,059 | \$ 223,828 |

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 Six Months Ended June 30, | |
|--|--|-------------|
| | 2018 | 2017 |
| Supplemental Disclosure of Cash and Non-Cash Flow Information | | |
| Cash paid during the period for: | | |
| Interest, net of amounts capitalized | \$ 178,850 | \$ 164,147 |
| Income taxes paid | \$ 5,625 | \$ 12,264 |
| Non-cash investing and financing activities: | | |
| Capital lease obligations incurred to acquire assets | \$ 499 | \$ — |
| Other comprehensive loss (income), net of tax benefit | \$ 17,826 | \$ (2,746) |

See accompanying notes to the unaudited consolidated financial statements.

SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
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, over our Internet radio service, including through applications for mobile devices, home devices and other consumer electronic equipment. We also provide 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, through which we acquire the majority of our subscribers. 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. Our satellite radios are primarily distributed through automakers, retailers, and 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 to annual, semi-annual, quarterly or monthly plans. 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 many cases, a subscription to our radio services is included with the purchase 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 and pay revenue share to various automakers.

As of June 30, 2018, Liberty Media Corporation (“Liberty Media”) beneficially owned, directly and indirectly, approximately 70% 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.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). Certain numbers in our prior period consolidated financial statements and footnotes have been reclassified or consolidated to conform to our current period presentation.

The unaudited consolidated financial statements for Sirius XM for the quarterly period ended June 30, 2018 are essentially identical to the unaudited consolidated financial statements included in Holdings' Form 10-Q for the quarterly period ended June 30, 2018, filed with the SEC on July 25, 2018, 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, dividend payments on shares of Holdings' common stock, the issuance of equity related to stock-based compensation to Sirius XM employees, Holdings' directors and third parties and the issuance of Holdings' common stock related to the recapitalization of Sirius XM Canada have been reported as related party transactions within Sirius XM's unaudited consolidated financial statements. Refer to Note 9 for additional information related to related party transactions.

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 June 30, 2018 and for the three and six months ended June 30, 2018 and 2017 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, 2017, which is available on our website at <http://investor.siriusxm.com/investor->

SIRIUS XM RADIO INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)
(Dollars and shares in thousands, except per share amounts)

overview/default.aspx#dividend-tab2, and with Holdings' Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on January 31, 2018.

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 maker 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 six months ended June 30, 2018 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 15.

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.

(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 June 30, 2018 and December 31, 2017, 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:

| | June 30, 2018 | | | | December 31, 2017 | | | |
|---|---------------|-------------|---------|------------------|-------------------|-------------|---------|------------------|
| | Level 1 | Level 2 | Level 3 | Total Fair Value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| Assets: | | | | | | | | |
| Pandora Media, Inc. ("Pandora") - investment ^(a) | — | \$ 597,921 | — | \$ 597,921 | — | \$ 480,472 | — | \$ 480,472 |
| Liabilities: | | | | | | | | |
| Debt ^(b) | — | \$6,342,699 | — | \$6,342,699 | — | \$6,987,473 | — | \$6,987,473 |

- (a) During the year ended December 31, 2017, we completed a \$480,000 investment in Pandora. We have elected the fair value option to account for this investment. Refer to Note 9 for information on this transaction.
- (b) The fair value for non-publicly traded debt is based upon estimates from a market maker and brokerage firm. Refer to Note 10 for information related to the carrying value of our debt as of June 30, 2018 and December 31, 2017.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income of \$4,594 was primarily comprised of the cumulative foreign currency translation adjustments related to our investment in and loan to Sirius XM Canada Holdings Inc. ("Sirius XM Canada") (refer to Note 9 for additional information). During the three and six months ended June 30, 2018, we recorded a foreign currency translation adjustment loss of \$8,242 and \$17,826 net of tax of \$2,663 and \$5,735, respectively. In addition, we reclassified stranded tax effects of \$4,013 related to the adoption of Accounting Standards Update ("ASU") 2018-02, *Income Statement -*

SIRIUS XM RADIO INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)
(Dollars and shares in thousands, except per share amounts)

Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, during the six months ended June 30, 2018.

Recent Accounting Pronouncements

In June 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-07, *Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, which simplifies the accounting for share-based payments made to nonemployees so the accounting for such payments is substantially the same as those made to employees. Under this ASU, share based awards to nonemployees will be measured at fair value on the grant date of the awards, entities will need to assess the probability of satisfying performance conditions if any are present, and awards will continue to be classified according to Accounting Standards Codification ("ASC") 718 upon vesting which eliminates the need to reassess classification upon vesting, consistent with awards granted to employees. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and early adoption is permitted. We are in the process of evaluating the impact of adoption of this ASU on our consolidated financial statements.

In February 2016, 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. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and early adoption is permitted. The FASB recently issued an exposure draft amending certain aspects of the new leasing standard. The proposed amendment allows adoption of the standard as of the effective date without restating prior periods. We plan to adopt this ASU on January 1, 2019. We expect the adoption of ASU 2016-02 will result in the recognition of right-of-use assets and lease liabilities on our consolidated balance sheets for operating leases.

Recently Adopted Accounting Policies

ASU 2014-09, Revenue - Revenue from Contracts with Customers. In May 2014, the FASB issued ASU 2014-09 which requires entities to recognize revenues when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. We adopted ASU 2014-09, and all related amendments, which established ASC Topic 606 (the "new revenue standard"), effective as of January 1, 2018. We adopted the new revenue standard using the modified retrospective method by recognizing the cumulative effect of initially applying the new revenue standard to all non-completed contracts as of January 1, 2018 as an adjustment to opening Accumulated deficit in the period of adoption. Results for reporting periods beginning after January 1, 2018 are presented under the new revenue standard, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

The new revenue standard primarily impacts how we account for revenue share payments and also has other immaterial impacts.

Revenue Share - Paid Trials

We previously recorded revenue share related to paid trials as Revenue share and royalties expense. Under the new revenue standard, we have recorded these revenue share payments as a reduction to revenue as the payments do not transfer a distinct good or service to us. Prior to the adoption, we recognized revenue share related to paid trial subscriptions as the Current portion of deferred revenue. Under the new revenue standard, we reclassified the revenue share related to paid trial subscriptions existing as of the date of adoption from Current portion of deferred revenue to Accounts payable and accrued expenses. For new paid trial subscriptions, the net amount of the paid trial subscription will be recorded as deferred revenue and the portion of revenue share will be recorded to Accounts payable and accrued expenses.

Other Impacts

SIRIUS XM RADIO INC. AND SUBSIDIARIES
(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)
(Dollars and shares in thousands, except per share amounts)

Other impacts of the new revenue standard include:

- Activation fees were previously recognized over the expected subscriber life using the straight-line method. Under the new revenue standard, the activation fees have been recognized over a one month period from activation as the activation fees are non-refundable and they do not convey a material right. As of January 1, 2018, we reduced deferred revenue related to activation fees of \$8,260, net of tax, to Accumulated deficit.
- Loyalty payments to OEMs were previously expensed when incurred as Subscriber acquisition costs. Under the new revenue standard, these costs have been capitalized in Prepaid expenses and other current assets as costs to obtain a contract and these costs will be amortized to Subscriber acquisition costs over an average self-pay subscriber life of that OEM. As of January 1, 2018, we capitalized previously expensed loyalty payments of \$10,156, net of tax, to Prepaid expenses and other current assets by reducing Accumulated deficit.

These changes do not have a material impact to our financial statements.

ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. In February 2018, the FASB issued ASU 2018-02 to amend its standard on comprehensive income to provide an option for an entity to reclassify the stranded tax effects of the Tax Cuts and Jobs Act (the “Tax Act”) that was passed in December 2017 from accumulated other comprehensive income (“AOCI”) directly to retained earnings. The stranded tax effects result from the remeasurement of deferred tax assets and liabilities which were originally recorded in comprehensive income but whose remeasurement is reflected in the income statement. The guidance is effective for interim and fiscal years beginning after December 15, 2018, with early adoption permitted. We elected to adopt ASU 2018-02 effective January 1, 2018 and reclassified the stranded tax effects due to the Tax Act of \$4,013 related to the currency translation adjustment from our investment balance and note receivable with Sirius XM Canada from AOCI to Accumulated deficit.

The cumulative effect of the changes made to our consolidated balance sheet as of January 1, 2018 for the adoption of ASU 2014-09 and ASU 2018-02 are included in the table below.

| | Balance at December 31, 2017 | Adjustments Due to ASU 2014-09 | Adjustments Due to ASU 2018-02 | Balance at January 1, 2018 |
|---|---------------------------------|-----------------------------------|-----------------------------------|-------------------------------|
| Balance Sheet | | | | |
| <u>Assets</u> | | | | |
| Prepaid expenses and other current assets | \$ 129,669 | \$ 8,262 | \$ — | \$ 137,931 |
| Other long-term assets | 118,671 | 2,576 | — | 121,247 |
| Deferred tax assets | 505,528 | (5,915) | — | 499,613 |
| <u>Liabilities:</u> | | | | |
| Accounts payable and accrued expenses | 768,077 | 32,399 | — | 800,476 |
| Current portion of deferred revenue | 1,881,825 | (41,902) | — | 1,839,923 |
| Deferred revenue | 174,579 | (3,990) | — | 170,589 |
| <u>Equity:</u> | | | | |
| Accumulated deficit | (3,635,628) | 18,416 | (4,013) | (3,621,225) |
| AOCI, net of tax | 18,407 | — | 4,013 | 22,420 |

The following table illustrates the impact of adopting ASU 2014-09 on our unaudited consolidated statement of comprehensive income. The adoption of ASU 2018-02 did not impact our unaudited consolidated statement of comprehensive income.

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(a wholly-owned subsidiary of Sirius XM Holdings Inc.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued
(UNAUDITED)
(Dollars and shares in thousands, except per share amounts)

| | For the Three Months Ended June 30, 2018 | | | For the Six Months Ended June 30, 2018 | | |
|------------------------------|--|--------------------------------|--|--|--------------------------------|--|
| | As Reported | Impact of Adopting ASU 2014-09 | Balances Without Adoption of ASU 2014-09 | As Reported | Impact of Adopting ASU 2014-09 | Balances Without Adoption of ASU 2014-09 |
| Income Statement | | | | | | |
| <u>Revenues</u> | | | | | | |
| Subscriber revenue | \$ 1,138,962 | \$ 23,787 | \$ 1,162,749 | \$ 2,256,046 | \$ 48,179 | \$ 2,304,225 |
| <u>Expenses</u> | | | | | | |
| Revenue share and royalties | 404,284 | 22,235 | 426,519 | 714,416 | 44,304 | 758,720 |
| Subscriber acquisition costs | 119,778 | 800 | 120,578 | 242,471 | 1,845 | 244,316 |
| Income tax expense | (70,570) | (146) | (70,716) | (150,819) | (418) | (151,237) |
| Net Income | \$ 292,352 | \$ 606 | \$ 292,958 | \$ 581,793 | \$ 1,612 | \$ 583,405 |

The adoption of the new revenue standard did not have a material impact on our unaudited consolidated balance sheet as of June 30, 2018.

ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. This ASU updates the guidance related to the statement of cash flows and requires that the statement include restricted cash with cash and cash equivalents when reconciling beginning and ending cash. The guidance was effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. We adopted this ASU effective January 1, 2018. As a result of the adoption, we have added restricted cash to the reconciliation of beginning and ending cash and cash equivalents and included a reconciliation of total cash, cash equivalents and restricted cash to the balance sheet for each period presented in the unaudited consolidated statements of cash flows.

(3) Revenues

Adoption of the new revenue standard

We adopted the new revenue standard using the modified retrospective method by recognizing the cumulative effect of initially applying the new revenue standard to all non-completed contracts as of January 1, 2018 as an adjustment to opening Accumulated deficit in the period of adoption. Results for reporting periods beginning after January 1, 2018 are presented under the new revenue standard, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC Topic 605.

Disaggregation of Revenue

We disaggregate our revenues as shown in the unaudited consolidated statements of comprehensive income.

Nature of goods and services

The following is a description of principal activities from which we generate our revenue, including from subscribers, advertising, and sales of equipment.

Subscription Revenue

Subscription revenue consists primarily of subscription fees and other ancillary subscription based revenues. Revenue is recognized on a straight line basis when the performance obligations to provide each service for the period are satisfied, which is over time as our subscription services are continuously transmitted and can be consumed by customers at any time. Consumers purchasing or leasing a vehicle with a factory-installed satellite radio typically receive between a three and twelve

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month subscription to our service. In certain cases, the subscription fees for these consumers are prepaid by the applicable automaker. Prepaid subscription fees received from certain automakers or directly from consumers are recorded as deferred revenue and amortized to revenue ratably over the service period which commences upon sale and activation. Activation fees are recognized over one month as the activation fees are non-refundable and do not provide for a material right to the customer. There is no revenue recognized for unpaid trial subscriptions. In some cases we pay a loyalty fee to the OEM when we receive a certain amount of payments from self-pay customers acquired from that OEM. These fees are considered incremental costs to obtain a contract and are, therefore, recognized as an asset and amortized to Subscriber acquisition costs over an average subscriber life of that OEM. Revenue share and loyalty fees paid to the OEM offering a paid trial are accounted for as a reduction of revenue as the payment does not provide a distinct good or service.

Advertising Revenue

We recognize revenue from the sale of advertising as performance obligations are satisfied upon airing of the advertising; therefore, revenue is recognized at a point in time when each advertising spot is transmitted. Agency fees are calculated based on a stated percentage applied to gross billing revenue for our advertising inventory and are reported as a reduction of advertising revenue. Additionally, we pay certain third parties a percentage of advertising revenue. Advertising revenue is recorded gross of such revenue share payments as we control the advertising service, including the ability to establish pricing, and we are primarily responsible for providing the service. Advertising revenue share payments are recorded to Revenue share and royalties during the period in which the advertising is transmitted.

Equipment Revenue

Equipment revenue and royalties from the sale of satellite radios, components and accessories are recognized when the performance obligation is satisfied and control is transferred, which is generally upon shipment. Revenue is recognized net of discounts and rebates.

Music Royalty Fee and Other Revenue

Music Royalty Fee and Other Revenue primarily consists of U.S. music royalty fees ("MRF"). The related costs we incur for the right to broadcast music and other programming are recorded as Revenue share and royalties expense. Fees received from subscribers for the MRF are recorded as deferred revenue and amortized to revenue ratably over the service period as the royalties relate to the subscription services which are continuously delivered to our customers.

Deferred Revenue

Customers generally pay for the services in advance of the performance obligation and therefore these prepayments are recorded as deferred revenue. The deferred revenue is recognized as revenue in our unaudited consolidated statement of comprehensive income as the services are provided. Changes in the liability balance during the period ended June 30, 2018 was not materially impacted by other factors.

Transaction Price Allocated to the Remaining Performance Obligations

As the majority of our contracts are one year or less, we have utilized the optional exemption under ASC 606-10-50-14 and will not disclose information about the remaining performance obligations for contracts which have original expected durations of one year or less. As of June 30, 2018, less than ten percent of our total deferred revenue balance related to contracts that extended beyond one year. These contracts primarily include prepaid data trials which are typically provided for three to five years as well as for self-pay customers who prepay for their audio subscriptions for up to three years in advance. These amounts will be recognized on a straight-line basis as our services are provided.

(4) Receivables, net

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

Customer accounts receivable, net, includes receivables from our subscribers and other customers, including advertising, and is stated at amounts due, net of an allowance for doubtful accounts. Our allowance for doubtful accounts is based upon our

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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.

Receivables, net, consists of the following:

| | June 30, 2018 | December 31, 2017 |
|------------------------------------|-------------------|-------------------|
| Gross customer accounts receivable | \$ 105,764 | \$ 100,342 |
| Allowance for doubtful accounts | (8,302) | (9,500) |
| Customer accounts receivable, net | \$ 97,462 | \$ 90,842 |
| Receivables from distributors | 121,407 | 121,410 |
| Other receivables | 28,279 | 29,475 |
| Total receivables, net | <u>\$ 247,148</u> | <u>\$ 241,727</u> |

(5) Inventory, net

Inventory consists of finished goods, refurbished goods, chipsets and other raw material components used in manufacturing radios and connected vehicle devices. 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 channel is reported as a component of Subscriber acquisition costs in our unaudited consolidated statements of comprehensive income.

Inventory, net, consists of the following:

| | June 30, 2018 | December 31, 2017 |
|----------------------------|------------------|-------------------|
| Raw materials | \$ 5,615 | \$ 6,489 |
| Finished goods | 18,915 | 21,225 |
| Allowance for obsolescence | (5,563) | (7,515) |
| Total inventory, net | <u>\$ 18,967</u> | <u>\$ 20,199</u> |

(6) 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. ASC 350, *Intangibles - Goodwill and Other*, states that an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value.

As of June 30, 2018, there were no indicators of impairment, and no impairment losses were recorded for goodwill during the three and six months ended June 30, 2018 and 2017. As of June 30, 2018, the cumulative balance of goodwill impairments recorded since the July 2008 merger (the "Merger") between our wholly owned subsidiary, Vernon Merger

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Corporation, and XM Satellite Radio Holdings Inc. ("XM"), was \$4,766,190, which was recognized during the year ended December 31, 2008.

(7) Intangible Assets

Our intangible assets include the following:

| | | June 30, 2018 | | | December 31, 2017 | | |
|------------------------------------|-------------------------------------|----------------------------|-----------------------------|-----------------------|----------------------------|-----------------------------|-----------------------|
| | Weighted Average Useful Lives | 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 |
| Trademarks | Indefinite | 250,800 | — | 250,800 | 250,800 | — | 250,800 |
| Definite life intangible assets: | | | | | | | |
| Subscriber relationships | 9 years | — | — | — | 380,000 | (380,000) | — |
| OEM relationships | 15 years | 220,000 | (68,444) | 151,556 | 220,000 | (61,111) | 158,889 |
| Licensing agreements | 12 years | 45,289 | (36,193) | 9,096 | 45,289 | (34,350) | 10,939 |
| Software and technology | 7 years | 33,872 | (17,857) | 16,015 | 43,915 | (25,351) | 18,564 |
| Total intangible assets | | \$ 2,633,615 | \$ (122,494) | \$ 2,511,121 | \$ 3,023,658 | \$ (500,812) | \$ 2,522,846 |

Indefinite Life Intangible Assets

We have identified our FCC licenses and the XM and Automatic Labs Inc. trademarks 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-5 | 2025 |
| SIRIUS FM-6 | 2022 |
| XM-3 | 2021 |
| XM-4 | 2022 |
| XM-5 | 2018 |

Prior to expiration, 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 life 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 June 30, 2018, there were no indicators of impairment, and no impairment loss was recognized for intangible assets with indefinite lives during the three and six months ended June 30, 2018 and 2017.

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Definite Life Intangible Assets

Amortization expense for all definite life intangible assets was \$5,863 and \$12,098 for the three months ended June 30, 2018 and 2017, respectively, and \$11,725 and \$23,626 for the six months ended June 30, 2018 and 2017, respectively. We retired definite lived intangible assets of \$390,043 during the six months ended June 30, 2018 primarily related to fully amortized subscriber relationships. There were no retirements of definite lived intangible assets during the six months ended June 30, 2017. The expected amortization expense for the remaining period in 2018, each of the fiscal years 2019 through 2022 and for periods thereafter is as follows:

| Years ending December 31, | Amount |
|--|-------------------|
| 2018 (remaining) | \$ 11,413 |
| 2019 | 22,701 |
| 2020 | 22,121 |
| 2021 | 16,678 |
| 2022 | 15,542 |
| Thereafter | 88,212 |
| Total definite life intangible assets, net | <u>\$ 176,667</u> |

(8) Property and Equipment

Property and equipment, net, consists of the following:

| | June 30, 2018 | December 31, 2017 |
|--|----------------------|--------------------------|
| Satellite system | \$ 1,586,794 | \$ 1,586,794 |
| Terrestrial repeater network | 124,904 | 123,254 |
| Leasehold improvements | 59,477 | 57,635 |
| Broadcast studio equipment | 101,338 | 96,582 |
| Capitalized software and hardware | 719,433 | 639,516 |
| Satellite telemetry, tracking and control facilities | 74,201 | 69,147 |
| Furniture, fixtures, equipment and other | 98,849 | 96,965 |
| Land | 38,411 | 38,411 |
| Building | 61,844 | 61,824 |
| Construction in progress | 347,196 | 301,153 |
| Total property and equipment | 3,212,447 | 3,071,281 |
| Accumulated depreciation and amortization | (1,743,517) | (1,608,515) |
| Property and equipment, net | <u>\$ 1,468,930</u> | <u>\$ 1,462,766</u> |

Construction in progress consists of the following:

| | June 30, 2018 | December 31, 2017 |
|-----------------------------------|----------------------|--------------------------|
| Satellite system | \$ 231,047 | \$ 183,243 |
| Terrestrial repeater network | 2,972 | 2,515 |
| Capitalized software and hardware | 95,555 | 94,456 |
| Other | 17,622 | 20,939 |
| Construction in progress | <u>\$ 347,196</u> | <u>\$ 301,153</u> |

Depreciation and amortization expense on property and equipment was \$68,760 and \$61,421 for the three months ended June 30, 2018 and 2017, respectively, and \$135,110 and \$126,597 for the six months ended June 30, 2018 and 2017,

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respectively. We retired property and equipment of \$14,760 during the six months ended June 30, 2017. There were no retirements of property and equipment during the six months ended June 30, 2018.

We capitalize a portion of the interest on funds borrowed to finance the construction and launch of our satellites. Capitalized interest is recorded as part of the asset's cost and depreciated over the satellite's useful life. Capitalized interest costs were \$2,901 and \$1,005 for the three months ended June 30, 2018 and 2017, respectively, and \$5,155 and \$1,723 for the six months ended June 30, 2018 and 2017, respectively, which related to the construction of our SXM-7 and SXM-8 satellites.

Satellites

As of June 30, 2018, we owned a fleet of five satellites. The chart below provides certain information on our satellites as of June 30, 2018:

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

(9) Related Party Transactions

In the normal course of business, we enter into transactions with related parties such as Liberty Media, Sirius XM Canada and Pandora.

Liberty Media

As of June 30, 2018, Liberty Media beneficially owned, directly and indirectly, approximately 70% of the outstanding shares of Holdings' common stock. Liberty Media 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.

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, dividend payments on shares of Holdings' common stock, the issuance of equity related to stock-based compensation for Sirius XM employees, Holdings' directors and third parties and the issuance of Holdings' common stock related to the recapitalization of Sirius XM Canada have been reported as related party transactions within our unaudited consolidated financial statements. The stock-based compensation for Sirius XM employees, Holdings' directors and third parties has been recorded in our unaudited consolidated financial statements. The Related party long-term assets balance as of June 30, 2018 and December 31, 2017 of Sirius XM includes \$6,976,764 and \$6,559,927, respectively, primarily for net amounts due from Holdings in connection with these equity-related transactions.

During the six months ended June 30, 2018, we used \$432,899 of our cash for the purchase and retirement of shares of Holdings' common stock under Holdings' repurchase program and payment of a cash dividend on Holdings' common stock. This amount is included in our Related party long-term asset balance as a receivable due from Holdings.

Sirius XM Canada

On May 25, 2017, we completed a recapitalization of Sirius XM Canada (the "Transaction"), which is now a privately held corporation.

Following the Transaction, we hold a 70% equity interest and 33% voting interest in Sirius XM Canada, with the remainder of the voting power and equity interests held by two of Sirius XM Canada's previous shareholders. The total

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consideration from us to Sirius XM Canada, excluding transaction costs, during the year ended December 31, 2017 was \$308,526, which included \$129,676 in cash and Holdings issued common stock with an aggregate value of \$178,850 to the holders of the shares of Sirius XM Canada acquired in the Transaction. We received common stock, non-voting common stock and preferred stock of Sirius XM Canada. Sirius XM and Holdings own, in the aggregate, 590,950 shares of preferred stock of Sirius XM Canada, which has a liquidation preference of one Canadian dollar per share.

In connection with the Transaction, we also made a contribution in the form of a loan to Sirius XM Canada in the aggregate amount of \$130,794. The loan is denominated in Canadian dollars and is considered a long-term investment with any unrealized gains or losses reported within Accumulated other comprehensive (loss) income. The loan has a term of fifteen years, bears interest at a rate of 7.62% per annum and includes customary covenants and events of default, including an event of default relating to Sirius XM Canada's failure to maintain specified leverage ratios. The terms of the loan require Sirius XM Canada to prepay a portion of the outstanding principal amount of the loan within sixty days of the end of each fiscal year in an amount equal to any cash on hand in excess of C\$10,000 at the last day of the financial year if all target dividends have been paid in full. During the six months ended June 30, 2018, Sirius XM Canada repaid \$3,242 of the principal amount of the loan.

In connection with the Transaction, we also entered into a Services Agreement and an Advisory Services Agreement with Sirius XM Canada. Each agreement has a thirty year term. Pursuant to the Services Agreement, Sirius XM Canada pays us 25% of its gross revenues on a monthly basis through December 31, 2021 and 30% of its gross revenues on a monthly basis thereafter. Pursuant to the Advisory Services Agreement, Sirius XM Canada pays us 5% of its gross revenues on a monthly basis. These agreements superseded and replaced the former agreements between Sirius XM Canada and its predecessors and us.

Sirius XM Canada is accounted for as an equity method investment, and its results are not consolidated in our unaudited consolidated financial statements. Sirius XM Canada does not meet the requirements for consolidation as we do not have the ability to direct the most significant activities that impact Sirius XM Canada's economic performance.

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

| | June 30, 2018 | December 31, 2017 |
|-------------------------------------|----------------------|--------------------------|
| Related party current assets | \$ 13,692 | \$ 10,284 |
| Related party long-term assets | \$ 453,416 | \$ 481,608 |
| Related party current liabilities | \$ 4,103 | \$ 2,839 |
| Related party long-term liabilities | \$ 6,269 | \$ 7,364 |

As of June 30, 2018 and December 31, 2017, our related party current asset balance included amounts due under the Services Agreement and Advisory Services Agreement and certain amounts related to transactions outside the scope of the new services arrangements. Our related party long-term assets balance as of June 30, 2018 and December 31, 2017 included the carrying value of our investment balance in Sirius XM Canada of \$323,226 and \$341,214, respectively, and, as of June 30, 2018 and December 31, 2017, also included \$130,190 and \$140,073, respectively, for the long-term value of the outstanding loan to Sirius XM Canada. Our related party liabilities as of each of June 30, 2018 and December 31, 2017 included \$2,776 for the current portion of deferred revenue and \$3,700 and \$5,088, respectively, for the long-term portion of deferred revenue recorded as of the Merger date related to agreements with legacy XM Canada, now Sirius XM Canada. These costs are being amortized on a straight line basis through 2020.

Sirius XM Canada paid gross dividends to us of \$408 during the three months ended June 30, 2018 and \$1,439 and \$3,796 during the six months ended June 30, 2018 and 2017, respectively. Sirius XM Canada did not pay any dividends to us during the three months ended June 30, 2017. Dividends are first recorded as a reduction to our investment balance in Sirius XM Canada to the extent a balance exists and then as Other income for any remaining portion.

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--------------------------------------|-------------------------------------|------------|-----------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue ^{(a)(b)} | \$ 23,273 | \$ 28,129 | \$ 47,370 | \$ 40,345 |
| Other income | | | | |
| Share of net earnings ^(b) | \$ (896) | \$ (5,197) | \$ 85 | \$ (2,183) |
| Interest income ^(c) | \$ 2,557 | \$ 803 | \$ 5,204 | \$ 803 |

- (a) Prior to the Transaction, under our former agreements with Sirius XM Canada, we received a percentage-based fee of 10% and 15% for certain types of subscription revenue earned by Sirius XM Canada for the use of the Sirius and XM platforms, respectively, and additional fees for premium services and fees 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.
- (b) Prior to the Transaction, we recognized our proportionate share of revenue and earnings or losses attributable to Sirius XM Canada on a one month lag. As a result of the Transaction, there is no longer a one-month lag and Sirius XM Canada changed its fiscal year-end to December 31 to align with us. For the three and six months ended June 30, 2018, Share of net earnings included \$611 and \$1,234, respectively, of amortization related to equity method intangible assets.
- (c) This interest income relates to the loan to Sirius XM Canada and is recorded as Other income in our unaudited consolidated statements of comprehensive income.

Pandora

On September 22, 2017, we completed a \$480,000 investment in Pandora. Pursuant to an Investment Agreement with Pandora, we purchased 480 shares of Pandora's Series A Convertible Preferred Stock, par value \$0.0001 per share (the "Series A Preferred Stock"), for an aggregate purchase price of \$480,000. As of June 30, 2018, the Series A Preferred Stock, including accrued but unpaid dividends, represents a stake of approximately 18% of Pandora's common stock outstanding and approximately a 15% interest on an as-converted basis. Pandora operates an internet-based music discovery platform, offering a personalized experience for listeners.

The Series A Preferred Stock is convertible at the option of the holders at any time into shares of common stock of Pandora ("Pandora Common Stock") at an initial conversion price of \$10.50 per share of Pandora Common Stock and an initial conversion rate of 95.2381 shares of Pandora Common Stock per share of Series A Preferred Stock, subject to certain customary anti-dilution adjustments. Holders of the Series A Preferred Stock are entitled to a cumulative dividend at the rate of 6.0% per annum, payable quarterly in arrears, if and when declared. Pandora has the option to pay dividends in cash when authorized by their Board and declared by Pandora or accumulate dividends in lieu of paying cash. Any conversion of Series A Preferred Stock may be settled by Pandora, at its option, in shares of Pandora Common Stock, cash or any combination thereof. However, unless and until Pandora's stockholders have approved the issuance of greater than 19.99% of the outstanding Pandora Common Stock, the Series A Preferred Stock may not be converted into more than 19.99% of Pandora's outstanding Pandora Common Stock as of June 9, 2017. The liquidation preference of the Series A Preferred Stock, including accrued dividends of \$25,684, was \$505,684 as of June 30, 2018.

The investment includes a mandatory redemption feature on any date from and after September 22, 2022 whereby we, at our option, may require Pandora to purchase the Series A Preferred Stock at a price equal to 100% of the liquidation preference plus accrued but unpaid dividends for, at the election of Pandora, cash, shares of Pandora Common Stock or a combination thereof, and as such the investment qualifies as a debt security under ASC 320, *Investments-Debt and Equity Securities*. As the investment includes a conversion option, we have elected to account for this investment under the fair value option to reduce the accounting asymmetry that would otherwise arise when recognizing the changes in the fair value of available-for-sale investments. Under the fair value option, any gains (losses) associated with the change in fair value will be recognized in Other income within our unaudited consolidated statements of comprehensive income. An \$86,074 and \$117,449 unrealized gain associated with this investment was recognized during the three and six months ended June 30, 2018, respectively, as Other income in our unaudited consolidated statements of comprehensive income. The fair value of our investment, including accrued dividends, as of June 30, 2018 and December 31, 2017 was \$597,921 and \$480,472, respectively, and is recorded as a related party long-term asset within our unaudited consolidated balance sheets. This investment does not meet the requirements for the equity method of accounting as it does not qualify as in-substance common stock.

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We have appointed James E. Meyer, our Chief Executive Officer, David J. Frear, our Senior Executive Vice President and Chief Financial Officer, and Gregory B. Maffei, the Chairman of Holdings' Board of Directors, to Pandora's Board of Directors pursuant to our designation rights under the Investment Agreement. Mr. Maffei also serves as the Chairman of Pandora's Board of Directors.

Our right to designate directors will fall away once we and our affiliates fail to beneficially own shares of Series A Preferred Stock and/or Pandora Common Stock issued upon conversion thereof equal to (on an as-converted basis) at least 50% of the number of shares of Pandora Common Stock issuable upon conversion of the Series A Preferred Stock purchased under the Investment Agreement. Following the earlier to occur of (i) September 22, 2019 and (ii) the date on which we and our affiliates fail to beneficially own shares of Series A Preferred Stock and/or Pandora Common Stock that were issued upon conversion thereof equal to (on an as-converted basis) at least 75% of the number of shares of Pandora Common Stock issuable upon conversion of the Series A Preferred Stock purchased under the Investment Agreement, we have the right to designate only two directors.

We are subject to certain standstill restrictions, including, among other things, that we are restricted from acquiring additional securities of Pandora until December 9, 2018.

Except as to matters that may be voted upon separately by holders of the Series A Preferred Stock, we are entitled to vote as a single class with the holders of Pandora Common Stock on an as-converted basis (up to a maximum of 19.99% of the Pandora Common Stock outstanding on June 9, 2017, unless stockholder approval has been received). We are also entitled to a separate class vote with respect to certain amendments to Pandora's organizational documents, issuances by Pandora of securities that are senior to, or equal in priority with, the Series A Preferred Stock and the incurrence of certain indebtedness by Pandora.

Upon certain change of control events involving Pandora, Pandora is required to repurchase all of the Series A Preferred Stock at a price equal to the greater of (1) an amount in cash equal to 100% of the liquidation preference thereof plus all accrued but unpaid dividends through June 9, 2022 (assuming such shares of Series A Preferred Stock remain outstanding through such date) and (2) the consideration the holders would have received if they had converted their shares of Series A Preferred Stock into Pandora Common Stock immediately prior to the change of control event (disregarding the 19.99% cap).

Beginning on September 22, 2020, if the volume weighted average price per share of Pandora Common Stock exceeds \$18.375, as may be adjusted, for at least 20 trading days in any period of 30 consecutive trading days, Pandora may redeem all of the outstanding Series A Preferred Stock at a price equal to 100% of the liquidation preference thereof plus all accrued but unpaid dividends for, at the election of Pandora, cash, shares of Pandora Common Stock or a combination thereof, provided that, unless stockholder approval has been received, Pandora may not settle the redemption for shares of Pandora Common Stock to the extent the 19.99% cap would be exceeded.

Pursuant to a registration rights agreement entered into with Pandora, Sirius XM has certain customary registration rights with respect to the Series A Preferred Stock and Pandora Common Stock issued upon conversion thereof.

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(10) Debt

Our debt as of June 30, 2018 and December 31, 2017 consisted of the following:

| Issuer / Borrower | Issued | Debt | Maturity Date | Interest Payable | Principal Amount at June 30, 2018 | Carrying value ^(a) at | |
|--|------------------|---|----------------|--|--------------------------------------|----------------------------------|---------------------|
| | | | | | | June 30, 2018 | December 31, 2017 |
| Sirius XM (b) | July 2017 | 3.875% Senior Notes | August 1, 2022 | semi-annually on February 1 and August 1 | \$ 1,000,000 | \$ 992,811 | \$ 992,011 |
| Sirius XM (b) | May 2013 | 4.625% Senior Notes | May 15, 2023 | semi-annually on May 15 and November 15 | 500,000 | 496,923 | 496,646 |
| Sirius XM (b) | May 2014 | 6.00% Senior Notes | July 15, 2024 | semi-annually on January 15 and July 15 | 1,500,000 | 1,488,758 | 1,488,002 |
| Sirius XM (b) | March 2015 | 5.375% Senior Notes | April 15, 2025 | semi-annually on April 15 and October 15 | 1,000,000 | 991,777 | 991,285 |
| Sirius XM (b) | May 2016 | 5.375% Senior Notes | July 15, 2026 | semi-annually on January 15 and July 15 | 1,000,000 | 990,597 | 990,138 |
| Sirius XM (b) | July 2017 | 5.00% Senior Notes | August 1, 2027 | semi-annually on February 1 and August 1 | 1,500,000 | 1,486,728 | 1,486,162 |
| Sirius XM (c) | December 2012 | Senior Secured Revolving Credit Facility (the "Credit Facility") | June 29, 2023 | variable fee paid quarterly | 1,750,000 | — | 300,000 |
| Sirius XM | Various | Capital leases | Various | n/a | n/a | 8,324 | 10,597 |
| Total Debt | | | | | | 6,455,918 | 6,754,841 |
| Less: total current maturities | | | | | | 4,660 | 5,105 |
| Less: total deferred financing costs for Notes | | | | | | 7,969 | 8,493 |
| Total long-term debt | | | | | | \$ 6,443,289 | \$ 6,741,243 |

- (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 June 2018, we entered into an amendment to extend the maturity of the Credit Facility to June 2023. 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 our 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 June 30, 2018. 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.

Covenants and Restrictions

Under the Credit Facility, we must comply with a debt maintenance covenant that cannot 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 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 our subsidiaries to create certain liens; enter into sale/leaseback transactions; and merge or consolidate.

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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 June 30, 2018 and December 31, 2017, we were in compliance with our debt covenants.

(11) 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 June 30, 2018 and 2017, there were one thousand shares of common stock of Sirius XM issued and outstanding, which were 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 June 30, 2018 and 2017.

(12) Benefit Plans

We recognized share-based payment expense of \$36,215 and \$30,251 for the three months ended June 30, 2018 and \$70,448 and \$59,697 for the six months ended June 30, 2018 and 2017, 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 deems appropriate. Stock-based awards under the 2015 Plan are generally subject to a graded vesting requirement, which is generally three to four years from the grant date. Stock options generally expire ten years from the date of grant. Restricted stock units include performance-based restricted stock units ("PRSUs"), the vesting of which are subject to the achievement of performance goals and the employee's continued employment and generally cliff vest on the third anniversary of the grant date. Each restricted stock unit entitles the holder to receive one share of common stock upon vesting. As of June 30, 2018, 171,619 shares of common stock were available for future grants under the 2015 Plan.

Other Plans

We maintain three other share-based benefit plans — the Sirius XM Radio Inc. 2009 Long-Term Stock Incentive Plan, the XM 2007 Stock Incentive Plan and the Amended and Restated Sirius Satellite Radio 2003 Long-Term Stock Incentive Plan. Excluding dividend equivalent units granted as a result of a declared dividend, no further awards may be made under these plans.

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 June 30, | | For the Six Months Ended June 30, | |
|----------------------------------|-------------------------------------|------|-----------------------------------|------|
| | 2018 | 2017 | 2018 | 2017 |
| Risk-free interest rate | 2.6% | 1.6% | 2.5% | 1.6% |
| Expected life of options — years | 3.48 | 4.35 | 3.54 | 4.07 |
| Expected stock price volatility | 22% | 26% | 22% | 26% |
| Expected dividend yield | 0.6% | 0.8% | 0.7% | 0.8% |

There were no options granted to third parties during the three and six months ended June 30, 2018 and 2017.

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The following table summarizes stock option activity under Holdings' share-based plans for the six months ended June 30, 2018:

| | Options | Weighted-Average Exercise Price Per Share | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|-------------------------------------|----------|---|---|---------------------------|
| Outstanding as of December 31, 2017 | 280,457 | \$ 3.76 | | |
| Granted | 10,617 | \$ 6.44 | | |
| Exercised | (41,644) | \$ 3.18 | | |
| Forfeited, cancelled or expired | (1,926) | \$ 4.48 | | |
| Outstanding as of June 30, 2018 | 247,504 | \$ 3.96 | 6.40 | \$ 695,499 |
| Exercisable as of June 30, 2018 | 115,544 | \$ 3.40 | 5.30 | \$ 389,015 |

The weighted average grant date fair value per share of stock options granted during the six months ended June 30, 2018 was \$1.19. The total intrinsic value of stock options exercised during the six months ended June 30, 2018 and 2017 was \$139,812 and \$47,572, respectively.

We recognized share-based payment expense associated with stock options of \$20,776 and \$20,125 for the three months ended June 30, 2018 and 2017, respectively, and \$40,435 and \$39,637 for the six months ended June 30, 2018 and 2017, respectively.

The following table summarizes the restricted stock unit, including PRSU, activity under our share-based plans for the six months ended June 30, 2018:

| | Shares | Grant Date Fair Value Per Share |
|-----------------------------------|---------|---------------------------------|
| Nonvested as of December 31, 2017 | 31,323 | \$ 4.54 |
| Granted | 7,123 | \$ 6.27 |
| Vested | (3,518) | \$ 3.92 |
| Forfeited | (569) | \$ 4.80 |
| Nonvested as of June 30, 2018 | 34,359 | \$ 4.93 |

The total intrinsic value of restricted stock units, including PRSUs, vesting during the six months ended June 30, 2018 and 2017 was \$22,656 and \$4,802, respectively. During the six months ended June 30, 2018, we granted 3,768 PRSUs to certain employees. We believe it is probable that the performance target applicable to these PRSUs will be achieved.

In connection with the cash dividends paid during the six months ended June 30, 2018, we granted 126 restricted stock units, including PRSUs, in accordance with the terms of existing award agreements. These grants did not result in any additional incremental share-based payment expense being recognized during the six months ended June 30, 2018.

We recognized share-based payment expense associated with restricted stock units, including PRSUs, of \$15,439 and \$10,126 for the three months ended June 30, 2018 and 2017, respectively, and \$30,013 and \$20,060 for the six months ended June 30, 2018 and 2017, respectively.

Total unrecognized compensation costs related to unvested share-based payment awards for stock options and restricted stock units, including PRSUs, granted to employees, members of Holdings' board of directors and third parties at June 30, 2018 and December 31, 2017 was \$251,588 and \$241,521, respectively. The total unrecognized compensation costs at June 30, 2018 are expected to be recognized over a weighted-average period of 1.72 years.

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401(k) Savings Plan

We sponsor 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 \$2,159 and \$1,835 in expense during three months ended June 30, 2018 and 2017, respectively, and \$4,028 and \$3,517 in expense during the six months ended June 30, 2018 and 2017, respectively, in connection with the Sirius XM Plan.

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’ cash compensation, as applicable. 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.

Contributions to the DCP, net of withdrawals, for the three months ended June 30, 2018 and 2017 were \$307 and \$334, respectively, and for the six months ended June 30, 2018 and 2017 were \$7,138 and \$7,355, respectively. As of June 30, 2018 and December 31, 2017, the fair value of the investments held in the trust were \$22,375 and \$14,641, respectively, which is included in Other long-term assets in our unaudited consolidated balance sheets and are classified as trading securities. Trading gains and losses associated with these investments 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. For the three and six months ended June 30, 2018 and 2017, we recorded an immaterial amount of unrealized gains on investments held in the trust.

(13) Commitments and Contingencies

The following table summarizes our expected contractual cash commitments as of June 30, 2018:

| | 2018 | 2019 | 2020 | 2021 | 2022 | Thereafter | Total |
|------------------------------|-------------------|-------------------|-------------------|-------------------|---------------------|---------------------|---------------------|
| Debt obligations | \$ 2,455 | \$ 3,935 | \$ 1,207 | \$ 727 | \$ 1,000,000 | \$ 5,500,000 | \$ 6,508,324 |
| Cash interest payments | 168,407 | 338,887 | 338,844 | 338,817 | 338,811 | 919,243 | 2,443,009 |
| Satellite and transmission | 59,557 | 94,922 | 51,056 | 4,347 | 2,428 | 4,288 | 216,598 |
| Programming and content | 136,122 | 251,953 | 207,728 | 118,706 | 52,475 | 162,938 | 929,922 |
| Sales and marketing | 9,990 | 12,817 | 7,701 | 7,446 | 1,644 | 203 | 39,801 |
| Satellite incentive payments | 8,001 | 10,652 | 10,197 | 8,574 | 8,558 | 61,767 | 107,749 |
| Operating lease obligations | 19,499 | 44,983 | 42,779 | 37,416 | 34,096 | 143,628 | 322,401 |
| Royalties and other | 230,132 | 139,285 | 103,414 | 86,253 | 23,199 | 33 | 582,316 |
| Total ⁽¹⁾ | <u>\$ 634,163</u> | <u>\$ 897,434</u> | <u>\$ 762,926</u> | <u>\$ 602,286</u> | <u>\$ 1,461,211</u> | <u>\$ 6,792,100</u> | <u>\$11,150,120</u> |

(1) The table does not include our reserve for uncertain tax positions, which at June 30, 2018 totaled \$15,344.

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.

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Satellite and transmission. We have entered into agreements with several third parties to design, build, launch and insure two satellites, SXM-7 and SXM-8. We also have entered into agreements with third parties to operate and maintain satellite telemetry, tracking and control facilities and certain components of our terrestrial repeater networks.

Programming and content. We have entered into various programming and content agreements. Under the terms of these agreements, our obligations include fixed payments, advertising commitments and revenue sharing arrangements. In certain of these agreements, the 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.

Sales and marketing. 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.

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 up to \$10,000 of additional incentive payments if our XM-4 satellite continues to operate above baseline specifications during the five years beyond the satellite's fifteen-year design life, which is currently not expected to occur.

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, SIRIUS FM-5 and SIRIUS 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.

Royalties and other. We have entered into certain music royalty arrangements that include fixed payments. We have also 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 other variable cost 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.

We also have a surety bond of approximately \$45,000 primarily used as security against non-performance in the normal course of business. 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

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uncertainty regarding the ultimate resolution of such matters, including the likelihood or magnitude of a possible eventual loss, if any.

SoundExchange Royalty Claims. On June 7, 2018, we entered into an agreement with SoundExchange, Inc., the organization that collects and distributes sound recording royalties pursuant to our statutory license, to settle the cases titled SoundExchange, Inc. v. Sirius XM Radio, Inc., No.13-cv-1290-RJL (D.D.C.), and SoundExchange, Inc. v. Sirius XM Radio, Inc., No.17-cv-02666-RJL (D.D.C.). A description of these actions is contained in our prior public filings. In connection with the settlement, we made a one-time lump sum payment of \$150,000 to SoundExchange on July 6, 2018. The settlement resolved all outstanding claims, including ongoing audits, under our statutory license for sound recordings for the period January 1, 2007 through December 31, 2017.

Telephone Consumer Protection Act Suits. On March 13, 2017, Thomas Buchanan, individually and on behalf of all others similarly situated, filed a class action complaint against us in the United States District Court for the Northern District of Texas, Dallas Division. The plaintiff in this action alleges that we violated the Telephone Consumer Protection Act of 1991 (the “TCPA”) by, among other things, making telephone solicitations to persons on the National Do-Not-Call registry, a database established to allow consumers to exclude themselves from telemarketing calls unless they consent to receive the calls in a signed, written agreement, and making calls to consumers in violation of our internal Do-Not-Call registry. The plaintiff is seeking various forms of relief, including statutory damages of five hundred dollars for each violation of the TCPA or, in the alternative, treble damages of up to fifteen hundred dollars for each knowing and willful violation of the TCPA and a permanent injunction prohibiting us from making, or having made, any calls to land lines that are listed on the National Do-Not-Call registry or our internal Do-Not-Call registry. We believe we have substantial defenses to the claims asserted in this action, and we 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.

(14) Income Taxes

For the three months ended June 30, 2018 and 2017, income tax expense was \$70,570 and \$119,513, respectively, and \$150,819 and \$233,486 for the six months ended June 30, 2018 and 2017, respectively.

Our effective tax rate for the three months ended June 30, 2018 and 2017 was 19.4% and 37.2%, respectively. Our effective tax rate for the six months ended June 30, 2018 and 2017 was 20.6% and 36.3%, respectively. The effective tax rate for the three and six months ended June 30, 2018 was primarily impacted by the reduced federal income tax rate as a result of the Tax Act and the recognition of excess tax benefits related to share based compensation. The effective tax rate for the three and six months ended June 30, 2017 was impacted by the recognition of excess tax benefits related to share based compensation. We estimate our effective tax rate for the year ending December 31, 2018 will be approximately 22%.

As of June 30, 2018 and December 31, 2017, we had a valuation allowance related to deferred tax assets of \$52,405 and \$52,883, 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.

(15) Subsequent Events

On July 18, 2018, Holdings' board of directors declared a quarterly dividend on Holdings' common stock in the amount of \$0.011 per share of Holdings' common stock payable on August 31, 2018 to Holdings' stockholders of record as of the close of business on August 10, 2018.

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, 2017.

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, 2017 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, 2017.

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 retain subscribers or increase the number of subscribers is uncertain;
- our ability to profitably attract and retain subscribers as our marketing efforts reach more price-sensitive consumers is uncertain;
- 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;
- our service may experience harmful interference from new wireless operations;
- we engage in extensive marketing efforts and the continued effectiveness of those efforts are an important part of our business;
- consumer protection laws and their enforcement could damage our business;
- we may not realize the benefits of acquisitions or other strategic investments and initiatives;
- the unfavorable outcome of pending or future litigation could have a material adverse impact on our operations and financial condition;
- 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;
- existing or future 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;
- rapid technological and industry changes and new entrants could adversely impact our services;
- failure of third parties to perform could adversely affect our business;
- 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 debt contains certain covenants that restrict our 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 Holdings' common stock;
- Holdings is a “controlled company” within the meaning of the NASDAQ listing rules and, as a result, qualify for, and rely 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, over our Internet radio service, including through applications for mobile devices, home devices and other consumer electronic equipment. We also provide 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, through which we acquire the majority of our subscribers. 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. Our satellite radios are primarily distributed through automakers; retailers; and our website. Satellite radio services are also offered to customers of certain rental car companies.

As of June 30, 2018, we had approximately 33.5 million subscribers of which approximately 28.2 million were self-pay subscribers and approximately 5.3 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 the Sirius XM Canada service, which had approximately 2.6 million subscribers as of June 30, 2018, and connected vehicle services 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 to annual, semi-annual, quarterly or monthly plans. We offer discounts for prepaid 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. We provide traffic services to approximately 8.1 million vehicles.

In many cases, a subscription to our radio service is included with the purchase 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 and pay revenue share to various automakers.

As of June 30, 2018, Liberty Media beneficially owned, directly and indirectly, approximately 70% 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.

We hold an equity method investment in Sirius XM Canada Holdings Inc. (“Sirius XM Canada”), which offers satellite radio services in Canada. As of June 30, 2018, we owned an approximate 70% equity interest and 33% voting interest in Sirius XM Canada.

We hold an investment in Pandora Media, Inc. (“Pandora”), which operates an internet-based music discovery platform, offering a personalized experience for listeners. As of June 30, 2018, our interest in Pandora represented an approximately 18% interest in Pandora's outstanding common stock, and an approximately 15% interest on an as-converted basis.

Results of Operations

Set forth below are our results of operations for the three and six months ended June 30, 2018 compared with the three and six months ended June 30, 2017.

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | | 2018 vs 2017 Change | | | |
|--|--|-------------------|--------------------------------------|-------------------|---------------------|-------|-------------------|------|
| | | | | | Three Months | | Six Months | |
| | 2018 | 2017 | 2018 | 2017 | Amount | % | Amount | % |
| Revenue: | | | | | | | | |
| Subscriber revenue | \$1,138,962 | \$1,111,011 | \$2,256,046 | \$2,189,268 | \$ 27,951 | 3 % | \$ 66,778 | 3 % |
| Advertising revenue | 47,242 | 40,178 | 89,290 | 76,194 | 7,064 | 18 % | 13,096 | 17 % |
| Equipment revenue | 36,840 | 29,674 | 71,929 | 59,332 | 7,166 | 24 % | 12,597 | 21 % |
| Music royalty fee and other revenue | 209,255 | 166,706 | 390,136 | 316,841 | 42,549 | 26 % | 73,295 | 23 % |
| Total revenue | 1,432,299 | 1,347,569 | 2,807,401 | 2,641,635 | 84,730 | 6 % | 165,766 | 6 % |
| Operating expenses: | | | | | | | | |
| Cost of services: | | | | | | | | |
| Revenue share and royalties | 404,284 | 292,893 | 714,416 | 570,193 | 111,391 | 38 % | 144,223 | 25 % |
| Programming and content | 105,650 | 96,255 | 206,486 | 191,799 | 9,395 | 10 % | 14,687 | 8 % |
| Customer service and billing | 95,582 | 95,324 | 189,447 | 192,099 | 258 | — % | (2,652) | (1)% |
| Satellite and transmission | 23,478 | 19,603 | 46,200 | 40,179 | 3,875 | 20 % | 6,021 | 15 % |
| Cost of equipment | 7,674 | 9,371 | 14,771 | 16,283 | (1,697) | (18)% | (1,512) | (9)% |
| Subscriber acquisition costs | 119,778 | 125,154 | 242,471 | 252,642 | (5,376) | (4)% | (10,171) | (4)% |
| Sales and marketing | 119,435 | 106,707 | 226,146 | 203,616 | 12,728 | 12 % | 22,530 | 11 % |
| Engineering, design and development | 27,485 | 27,783 | 58,122 | 51,600 | (298) | (1)% | 6,522 | 13 % |
| General and administrative | 92,683 | 84,607 | 177,289 | 162,808 | 8,076 | 10 % | 14,481 | 9 % |
| Depreciation and amortization | 74,623 | 73,519 | 146,835 | 150,223 | 1,104 | 2 % | (3,388) | (2)% |
| Total operating expenses | 1,070,672 | 931,216 | 2,022,183 | 1,831,442 | 139,456 | 15 % | 190,741 | 10 % |
| Income from operations | 361,627 | 416,353 | 785,218 | 810,193 | (54,726) | (13)% | (24,975) | (3)% |
| Other income (expense): | | | | | | | | |
| Interest expense | (86,917) | (82,794) | (176,706) | (164,451) | (4,123) | (5)% | (12,255) | (7)% |
| Other income (expense) | 88,212 | (11,937) | 124,100 | (3,074) | 100,149 | nm | 127,174 | nm |
| Total other income (expense) | 1,295 | (94,731) | (52,606) | (167,525) | 96,026 | 101 % | 114,919 | 69 % |
| Income before income taxes | 362,922 | 321,622 | 732,612 | 642,668 | 41,300 | 13 % | 89,944 | 14 % |
| Income tax expense | (70,570) | (119,513) | (150,819) | (233,486) | 48,943 | 41 % | 82,667 | 35 % |
| Net income attributable to Sirius XM Radio Inc.'s sole stockholder | <u>\$ 292,352</u> | <u>\$ 202,109</u> | <u>\$ 581,793</u> | <u>\$ 409,182</u> | <u>\$ 90,243</u> | 45 % | <u>\$ 172,611</u> | 42 % |

nm - not meaningful

Total Revenue

Subscriber Revenue includes subscription, activation and other fees.

For the three months ended June 30, 2018 and 2017, subscriber revenue was \$1,138,962 and \$1,111,011, respectively, an increase of 3%, or \$27,951. For the six months ended June 30, 2018 and 2017, subscriber revenue was \$2,256,046 and \$2,189,268, respectively, an increase of 3%, or \$66,778. The increases were primarily attributable to a 5% increase in the daily weighted average number of subscribers. Subscriber revenue was negatively impacted by \$23,787 and \$48,179, for the three and six months ended June 30, 2018, respectively, from the adoption of Accounting Standards Update ("ASU") 2014-09, *Revenue - Revenue from Contracts with Customers*, and all related amendments, which established Accounting Standards Codification ("ASC") Topic 606 (the "new revenue standard"), effective as of January 1, 2018.

We expect subscriber revenues to increase based on the growth of our subscriber base, increases in the average price charged 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 June 30, 2018 and 2017, advertising revenue was \$47,242 and \$40,178, respectively, an increase of 18%, or \$7,064. For the six months ended June 30, 2018 and 2017, advertising revenue was \$89,290 and \$76,194, respectively, an increase of 17%, or \$13,096. The increases were primarily due to a greater number of advertising spots sold and transmitted as well as increases in rates charged 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 from the sale of satellite radios, components and accessories as well as the sale of connected vehicle devices and royalty revenue on chipset modules.

For the three months ended June 30, 2018 and 2017, equipment revenue was \$36,840 and \$29,674, respectively, an increase of 24%, or \$7,166. For the six months ended June 30, 2018 and 2017, equipment revenue was \$71,929 and \$59,332, respectively, an increase of 21%, or \$12,597. The increases were driven by additional royalty revenue due to our transition to a new generation of chipsets and revenue from the sales of connected vehicle devices, partially offset by lower satellite radio sales to consumers.

We expect equipment revenue to increase as royalty revenues associated with certain new chipsets increases.

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

For the three months ended June 30, 2018 and 2017, other revenue was \$209,255 and \$166,706, respectively, an increase of 26%, or \$42,549. For the six months ended June 30, 2018 and 2017, other revenue was \$390,136 and \$316,841, respectively, an increase of 23%, or \$73,295. The increases were primarily driven by U.S. Music Royalty Fee revenue due to subscribers paying at a higher rate and an increase in the number of subscribers, higher revenue generated from our connected vehicle services, and revenue from Sirius XM Canada, which was mitigated by a one-time activation revenue resolution with Sirius XM Canada recorded in the second quarter of 2017.

Other revenue is expected to increase due to an increase in U.S. Music Royalty Fees as subscribers migrate to the new rate and as our subscriber base grows.

Operating Expenses

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

For the three months ended June 30, 2018 and 2017, revenue share and royalties were \$404,284 and \$292,893, respectively, an increase of 38%, or \$111,391, and increased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, revenue share and royalties were \$714,416 and \$570,193, respectively, an increase of 25%, or \$144,223, and increased as a percentage of total revenue. The increases were primarily due to a \$69,144 charge related to the legal settlement that resolved all outstanding claims, including ongoing audits, under our statutory license for sound recordings for the period January 1, 2007 through December 31, 2017, an increase in the statutory royalty rate applicable to our use of post-1972 recordings, which increased from 11% in 2017 to 15.5% in 2018 and overall greater revenues subject to revenue share with the automakers. The increase was partially offset by approximately \$22,235 and

\$44,304, for the three and six months ended June 30, 2018, respectively, related to the adoption of the new revenue standard effective as of January 1, 2018.

We expect our revenue share and royalty costs to increase as our revenues grow and as a result of the increase in the royalty rate.

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 June 30, 2018 and 2017, programming and content expenses were \$105,650 and \$96,255, respectively, an increase of 10%, or \$9,395, and increased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, programming and content expenses were \$206,486 and \$191,799, respectively, an increase of 8%, or \$14,687, and increased as a percentage of total revenue. The increases were primarily due to increased personnel-related costs, programming operations costs related to subscriber events, and higher music license fees.

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 June 30, 2018 and 2017, customer service and billing expenses were \$95,582 and \$95,324, respectively, a slight increase of \$258, but decreased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, customer service and billing expenses were \$189,447 and \$192,099, respectively, a decrease of 1%, or \$2,652, and decreased as a percentage of total revenue. The increased expenses for the three month period was driven primarily by increased transaction fees from a larger subscriber base and overhead costs, offset by lower call center costs due to lower agent and contact rates, and bad debt expense. The decreased expenses for the six month period was driven by lower call center costs due to lower agent and contact rates, and bad debt expense, partially offset by increased transaction fees from a larger subscriber base and overhead costs.

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 June 30, 2018 and 2017, satellite and transmission expenses were \$23,478 and \$19,603, respectively, an increase of 20%, or \$3,875, and increased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, satellite and transmission expenses were \$46,200 and \$40,179, respectively, an increase of 15%, or \$6,021, and increased as a percentage of total revenue. The increases were primarily driven by higher wireless costs associated with our connected vehicle services and higher Internet streaming costs.

We expect satellite and transmission expenses to increase as costs associated with our investment in Internet streaming increase.

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

For the three months ended June 30, 2018 and 2017, cost of equipment was \$7,674 and \$9,371, respectively, a decrease of 18%, or \$1,697, and decreased as a percentage of equipment revenue. For the six months ended June 30, 2018 and 2017, cost of equipment was \$14,771 and \$16,283, respectively, a decrease of 9%, or \$1,512, and decreased as a percentage of equipment revenue. The decreases were primarily due to lower satellite radio sales to consumers.

We expect cost of equipment to fluctuate with changes in sales of aftermarket radios.

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; product warranty obligations; and freight. The majority of subscriber acquisition costs are incurred and expensed in advance of 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 June 30, 2018 and 2017, subscriber acquisition costs were \$119,778 and \$125,154, respectively, a decrease of 4%, or \$5,376, and decreased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, subscriber acquisition costs were \$242,471 and \$252,642, respectively, a decrease of 4%, or \$10,171, and decreased as a percentage of total revenue. The decreases were driven by reductions to OEM hardware subsidy rates, lower subsidized costs related to the transition of chipsets, and a decrease in the volume of installations.

We expect subscriber acquisition costs to fluctuate with OEM installations and aftermarket volume; however, the subsidized chipsets cost is expected to decline as we transition to a new generation of chipsets. We intend to continue to offer subsidies and other incentives to induce OEMs to include our technology in their vehicles.

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 June 30, 2018 and 2017, sales and marketing expenses were \$119,435 and \$106,707, respectively, an increase of 12%, or \$12,728, and increased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, sales and marketing expenses were \$226,146 and \$203,616, respectively, an increase of 11%, or \$22,530, and increased as a percentage of total revenue. The increases were primarily due to additional subscriber communications, retention programs and acquisition campaigns, as well as higher personnel-related 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 June 30, 2018 and 2017, engineering, design and development expenses were \$27,485 and \$27,783, respectively, a decrease of 1%, or \$298, and decreased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, engineering, design and development expenses were \$58,122 and \$51,600, respectively, an increase of 13%, or \$6,522, and increased as a percentage of total revenue. The decrease for the three month period was driven by lower costs associated with the development of video streaming and our connected vehicle services, partially offset by higher costs associated with the development of our audio streaming product. The increase for the six month period was driven by the additional costs associated with our connected vehicle services and the development of our audio streaming product; partially offset by lower costs associated with the development of our video streaming product.

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 June 30, 2018 and 2017, general and administrative expenses were \$92,683 and \$84,607, respectively, an increase of 10%, or \$8,076, and increased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, general and administrative expenses were \$177,289 and \$162,808, respectively, an increase of 9%, or \$14,481, and increased as a percentage of total revenue. The increases were primarily driven by higher personnel-related costs and a one-time sales and use tax, partially offset by lower legal costs.

We expect our general and administrative expenses to increase 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 June 30, 2018 and 2017, depreciation and amortization expense was \$74,623 and \$73,519, respectively, an increase of 2%, or \$1,104, but decreased as a percentage of total revenue. For the six months ended June 30, 2018 and 2017, depreciation and amortization expense was \$146,835 and \$150,223, respectively, a decrease of 2%, or \$3,388, and decreased as a percentage of total revenue. The increase for the three month period was driven by additional assets placed in-service, partially offset by lower amortization expense due to our subscriber relationships and certain software assets being fully amortized during 2017. The decrease for the six month period was driven by lower amortization expense due to our subscriber relationships and certain software assets being fully amortized during 2017, partially offset by additional assets placed in-service.

Other Income (Expense)

Interest Expense includes interest on outstanding debt.

For the three months ended June 30, 2018 and 2017, interest expense was \$86,917 and \$82,794, respectively, an increase of 5%, or \$4,123. For the six months ended June 30, 2018 and 2017, interest expense was \$176,706 and \$164,451, respectively, an increase of 7%, or \$12,255. The increases were primarily due to higher average debt.

Other Income (Expense) primarily includes realized and unrealized gains and losses, interest and dividend income, our share of the income or loss of Sirius XM Canada, and transaction costs related to non-operating investments.

For the three months ended June 30, 2018 and 2017, other income (expense) was \$88,212 and \$(11,937), respectively. For the six months ended June 30, 2018 and 2017, other income (expense) was \$124,100 and \$(3,074), respectively. For the three and six months ended June 30, 2018, other income was driven by unrealized gains of \$86,074 and \$117,449 from a fair value adjustment of our investment in Pandora, respectively, and interest earned on our loan to Sirius XM Canada. For the three and six months ended June 30, 2017, other loss was driven by transaction costs associated with our investment in Pandora and our share of Sirius XM Canada's net loss.

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 June 30, 2018 and 2017, income tax expense was \$70,570 and \$119,513, respectively, and \$150,819 and \$233,486 for the six months ended June 30, 2018 and 2017, respectively.

Our effective tax rate for the three months ended June 30, 2018 and 2017 was 19.4% and 37.2%, respectively. Our effective tax rate for the six months ended June 30, 2018 and 2017 was 20.6% and 36.3%, respectively. The effective tax rate for the three and six months ended June 30, 2018 was primarily impacted by the reduced federal income tax rate as a result of the Tax Act and the recognition of excess tax benefits related to share based compensation. The effective tax rate for the three and six months ended June 30, 2017 was impacted by the recognition of excess tax benefits related to share based compensation. We estimate our effective tax rate for the year ending December 31, 2018 will be approximately 22%.

Key Financial and Operating Performance Metrics

In this section, we present certain financial performance measures some of which 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. Our adjusted EBITDA excludes 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 metric excludes 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 the accompanying glossary on pages 38 through 42 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 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 acquisitions and capital expenditures, to repurchase or retire debt, to acquire other companies and 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 38 through 42) 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 and Sirius XM Canada are not included in our subscriber count or subscriber-based operating metrics.

Set forth below are our subscriber balances as of June 30, 2018 compared to June 30, 2017:

| | As of June 30, | | 2018 vs 2017 Change | |
|-----------------------------------|----------------|--------|---------------------|------|
| | 2018 | 2017 | Amount | % |
| Self-pay subscribers | 28,203 | 26,675 | 1,528 | 6 % |
| Paid promotional subscribers | 5,292 | 5,372 | (80) | (1)% |
| Ending subscribers ^(a) | 33,495 | 32,048 | 1,447 | 5 % |

(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 six months ended June 30, 2018 and 2017. The ARPU and SAC, per installation, metrics for the three months ended June 30, 2018 have been reduced due to the adoption of the new revenue standard as of January 1, 2018 by \$0.24 and \$0.24, respectively. The ARPU and SAC, per installation, metrics for the six months ended June 30, 2018 have been reduced due to the adoption of the new revenue standard as of January 1, 2018 by \$0.24 and \$0.28, respectively. For more information regarding the impact on these metrics, refer to the glossary (pages 38 through 42). For more information regarding the adoption of the new revenue standard, refer to Note 2 to our unaudited consolidated financial statements of this Quarterly Report.

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | | 2018 vs 2017 Change | | | |
|---|-------------------------------------|------------|-----------------------------------|-------------|---------------------|--------|------------|-------|
| | | | | | Three Months | | Six Months | |
| | 2018 | 2017 | 2018 | 2017 | Amount | % | Amount | % |
| Self-pay subscribers | 483 | 466 | 690 | 725 | 17 | 4 % | (35) | (5)% |
| Paid promotional subscribers | (54) | (20) | 69 | (23) | (34) | (170)% | 92 | 400 % |
| Net additions ^(a) | 429 | 445 | 759 | 702 | (16) | (4)% | 57 | 8 % |
| Daily weighted average number of subscribers | 33,197 | 31,746 | 33,013 | 31,559 | 1,451 | 5 % | 1,454 | 5 % |
| Average self-pay monthly churn | 1.6% | 1.7% | 1.7% | 1.8% | (0.1)% | (6)% | (0.1)% | (6)% |
| New vehicle consumer conversion rate | 39% | 40% | 39% | 40% | (1)% | (3)% | (1)% | (3)% |
| ARPU | \$ 13.30 | \$ 13.22 | \$ 13.13 | \$ 13.08 | \$ 0.08 | 1 % | \$ 0.05 | — % |
| SAC, per installation | \$ 27.54 | \$ 31.19 | \$ 27.86 | \$ 30.18 | \$ (3.65) | (12)% | \$ (2.32) | (8)% |
| Customer service and billing expenses, per average subscriber | \$ 0.89 | \$ 0.94 | \$ 0.88 | \$ 0.95 | \$ (0.05) | (5)% | \$ (0.07) | (7)% |
| Adjusted EBITDA | \$ 543,422 | \$ 521,936 | \$1,075,271 | \$1,023,739 | \$ 21,486 | 4 % | \$ 51,532 | 5 % |
| Free cash flow | \$ 486,243 | \$ 416,725 | \$ 812,705 | \$ 665,664 | \$ 69,518 | 17 % | \$ 147,041 | 22 % |

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

Subscribers. At June 30, 2018, we had approximately 33.5 million subscribers, an increase of 1.4 million subscribers, or 5%, from the approximately 32.0 million subscribers as of June 30, 2017. The increase in total subscribers was primarily due to growth in our self-pay subscriber base, which increased 1.5 million, partially offset by an 80 thousand decrease in paid promotional subscribers. The increase in self-pay subscribers was primarily from original and subsequent owner trial conversions and subscriber win back programs, partially offset by deactivations.

For the three months ended June 30, 2018 and 2017, net additions were 429 thousand and 445 thousand, respectively, a decrease of 4%. Paid promotional net additions declined due to paid promotional ends out-pacing paid-promotional starts during the three months ended June 30, 2018. Self-pay net additions increased due to growth in trial conversions and subscriber win backs and improvements in our non-pay churn. For the six months ended June 30, 2018 and 2017, net additions were 759 thousand and 702 thousand, respectively, an increase of 8%. For the six month period, growth in paid promotional net additions was due to paid promotional subscription starts out-pacing paid promotional subscription ends as a result of higher shipments from automakers offering paid promotional subscriptions while self-pay net additions decreased due to growth in vehicle turnover out-pacing growth in trial conversions and subscriber win backs.

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 38 through 42 for more details.)

For the three months ended June 30, 2018 and 2017, our average self-pay monthly churn rate was 1.6% and 1.7%, respectively. For the six months ended June 30, 2018 and 2017, our average self-pay monthly churn rate was 1.7% and 1.8%, respectively. The decreases in churn were primarily driven by improvements in non-pay and voluntary churn.

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 38 through 42 for more details.)

For the three months ended June 30, 2018 and 2017, our new vehicle consumer conversion rate was 39% and 40%, respectively. For the six months ended June 30, 2018 and 2017, our new vehicle consumer conversion rate was 39% and 40%, respectively. The decrease in new vehicle consumer conversion rate was driven primarily by a decline in conversion of first time trial subscribers.

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 38 through 42 for more details.)

For the three months ended June 30, 2018 and 2017, ARPU was \$13.30 and \$13.22, respectively. For the six months ended June 30, 2018 and 2017, ARPU was \$13.13 and \$13.08, respectively. The increase in certain of our subscription rates, including the U. S. Music Royalty Fee, and higher advertising revenue was offset by the impact of the adoption of the new revenue standard, effective as of January 1, 2018 of \$0.24 for both the three and six month periods, and the 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 (excluding connected vehicle services), 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 38 through 42 for more details.)

For the three months ended June 30, 2018 and 2017, SAC, per installation, was \$27.54 and \$31.19, respectively. For the six months ended June 30, 2018 and 2017, SAC, per installation, was \$27.86 and \$30.18, respectively. The decreases were driven by reductions to OEM hardware subsidy rates, our transition to a new generation of chipsets as well as the impact of the adoption of the new revenue standard, effective as of January 1, 2018 of \$0.24 and \$0.28 for the three and six months ended June 30, 2018, respectively.

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 38 through 42 for more details.)

For the three months ended June 30, 2018 and 2017, customer service and billing expenses, per average subscriber, was \$0.89 and \$0.94, respectively. For the six months ended June 30, 2018 and 2017, customer service and billing expenses, per average subscriber, was \$0.88 and \$0.95, respectively. The decreases were primarily related to lower call center costs due to lower contact rates, agent rates, and bad debt expense.

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, loss on extinguishment of debt, other non-cash charges, such as certain purchase price accounting adjustments, share-based payment expense, loss on disposal of assets, and legal settlements and reserves related to the historical use of sound recordings. (See the accompanying glossary on pages 38 through 42 for a reconciliation to GAAP and for more details.)

For the three months ended June 30, 2018 and 2017, adjusted EBITDA was \$543,422 and \$521,936, respectively, an increase of 4%, or \$21,486. For the six months ended June 30, 2018 and 2017, adjusted EBITDA was \$1,075,271 and \$1,023,739, respectively, an increase of 5%, or \$51,532. The increases were due to growth of 6% in total revenue which was primarily a result of the increase in our subscriber base and certain of our subscription rates, additional revenues from the U.S. Music Royalty Fee, and an increase in other revenue from the new Sirius XM Canada service and advisory agreements as well as lower subscriber acquisition costs. The increases were partially offset by higher revenue share and royalty, programming and content, sales and marketing, engineering, design and development, and 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. (See the accompanying glossary on pages 38 through 42 for a reconciliation to GAAP and for more details.)

For the three months ended June 30, 2018 and 2017, free cash flow was \$486,243 and \$416,725, respectively, an increase of \$69,518, or 17%. For the six months ended June 30, 2018 and 2017, free cash flow was \$812,705 and \$665,664, respectively, an increase of \$147,041, or 22%. For the three month periods, the increase was driven by higher net cash provided by operating activities resulting from improved operating performance, the timing of payments to vendors, and the timing of interest payments, partially offset by an increase in additions to property and equipment resulting from new satellite construction. For the six month periods, the increase was driven by higher net cash provided by operating activities resulting from improved operating performance, the timing of payments to vendors, and the payment of a legal settlement during the first quarter of 2017, partially offset by an increase in additions to property and equipment resulting from new satellite construction.

Liquidity and Capital Resources

Cash Flows for the six months ended June 30, 2018 compared with the six months ended June 30, 2017.

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

| | For the Six Months Ended June 30, | | 2018 vs 2017 |
|---|-----------------------------------|------------|--------------|
| | 2018 | 2017 | |
| Net cash provided by operating activities | \$ 922,615 | \$ 769,941 | \$ 152,674 |
| Net cash used in investing activities | (184,307) | (667,248) | 482,941 |
| Net cash used in financing activities | (743,227) | (273,462) | (469,765) |
| Net decrease in cash, cash equivalents and restricted cash | (4,919) | (170,769) | 165,850 |
| Cash, cash equivalents and restricted cash at beginning of period | 79,374 | 223,828 | (144,454) |
| Cash, cash equivalents and restricted cash at end of period | \$ 74,455 | \$ 53,059 | \$ 21,396 |

Cash Flows Provided by Operating Activities

Cash flows provided by operating activities increased by \$152,674 to \$922,615 for the six months ended June 30, 2018 from \$769,941 for the six months ended June 30, 2017.

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 in the six months ended June 30, 2018 and 2017 were primarily due to additional spending to construct replacement satellites, improve our terrestrial repeater network, for capitalized software, and deferred compensation. We spent \$79,962 and \$35,494 to construct replacement satellites during the six months ended June 30, 2018 and 2017, respectively. In addition, cash flows used in investing activities in the first half of 2017 were primarily due to our investment in Pandora of \$172,500, loans to related parties of \$130,794, payments to acquire additional ownership in related parties (net of transaction costs) of \$129,676, and the acquisition of Automatic Labs Inc. for \$107,056 (net of cash and restricted cash acquired).

Cash Flows Used in Financing Activities

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

Cash flows used in financing activities in the six months ended June 30, 2018 were primarily due to the purchase and retirement of shares of Holdings' common stock under Holdings' repurchase program for \$334,215, the payment of cash dividends on Holdings' common stock of \$98,684 and repayment under the Credit Facility of \$302,611. Cash flows used in financing activities in the six months ended June 30, 2017 were primarily due to the purchase and retirement for \$783,824 of shares of Holdings' common stock under Holdings' repurchase program, and the payment of cash dividends of \$93,638, partially offset by net borrowings of \$610,000 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 June 30, 2018, \$1,750,000 was available for future borrowing 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 of our satellite spend, as well as fund Holdings' stock repurchases, future dividend payments on Holdings' common stock 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 and investments, including acquisitions and investments that are not directly related to our satellite radio business.

Holdings' Capital Return Program

As of June 30, 2018, Holdings' board of directors had authorized for repurchase an aggregate of \$12,000,000 of Holdings common stock. As of June 30, 2018, Holdings' cumulative repurchases since December 2012 under Holdings' stock repurchase program totaled \$9,694,181, and \$2,305,819 remained available for additional repurchases under Holdings' existing stock repurchase program authorization.

Shares of 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 through a combination of cash on hand, cash generated by operations and future borrowings.

On July 18, 2018, Holdings board of directors declared a quarterly dividend on Holdings' common stock in the amount of \$0.011 per share of Holdings' common stock payable on August 31, 2018 to Holdings' stockholders of record as of the close

of business on August 10, 2018. Holdings' board of directors expects to declare regular quarterly dividends, in an aggregate annual amount of \$0.044 per share of Holdings' common stock.

Debt Covenants

The indentures governing our senior notes and the agreement governing the Credit Facility include restrictive covenants. As of June 30, 2018, we were in compliance with such covenants. For a discussion of our “Debt Covenants,” refer to Note 10 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 13 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 13 to our unaudited consolidated financial statements in this Quarterly Report.

Related Party Transactions

For a discussion of “Related Party Transactions,” refer to Note 9 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, 2017. There have been no material changes to our critical accounting policies and estimates since December 31, 2017.

We adopted the new revenue standard using the modified retrospective method by recognizing the cumulative effect of initially applying the new revenue standard to all non-completed contracts as of January 1, 2018 as an adjustment to opening Accumulated deficit in the period of adoption. For more information regarding the adoption of the new revenue standard, refer to Note 2 to our unaudited consolidated financial statements of this Quarterly Report.

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 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 past operating performance with our current performance 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. As a result 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 the legal settlements and reserves related to the historical use of sound recordings, loss on extinguishment of debt and loss on disposal of assets, to the extent they occur during the period, is useful as they are significant expenses not 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 June 30, | | For the Six Months Ended June 30, | |
|--|-------------------------------------|-------------------|-----------------------------------|---------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income: | \$ 292,352 | \$ 202,109 | \$ 581,793 | \$ 409,182 |
| Add back items excluded from Adjusted EBITDA: | | | | |
| Purchase price accounting adjustments: | | | | |
| Revenues | 1,813 | 1,813 | 3,626 | 3,626 |
| Sound recording legal settlements and reserves | 69,144 | — | 69,144 | — |
| Share-based payment expense | 36,215 | 30,251 | 70,448 | 59,697 |
| Depreciation and amortization | 74,623 | 73,519 | 146,835 | 150,223 |
| Interest expense | 86,917 | 82,794 | 176,706 | 164,451 |
| Other (income) expense | (88,212) | 11,937 | (124,100) | 3,074 |
| Income tax expense | 70,570 | 119,513 | 150,819 | 233,486 |
| Adjusted EBITDA | <u>\$ 543,422</u> | <u>\$ 521,936</u> | <u>\$ 1,075,271</u> | <u>\$ 1,023,739</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. The ARPU for the three and six months ended June 30, 2018 reflects adjustments as a result of adopting the new revenue standard as of January 1, 2018. ARPU is calculated as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--|-------------------------------------|---------------------|-----------------------------------|---------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Subscriber revenue, excluding connected vehicle services | \$ 1,112,652 | \$ 1,090,356 | \$ 2,204,901 | \$ 2,148,410 |
| Add: advertising revenue | 47,242 | 40,178 | 89,290 | 76,194 |
| Add: other subscription-related revenue | 165,058 | 128,179 | 305,874 | 252,647 |
| | <u>\$ 1,324,952</u> | <u>\$ 1,258,713</u> | <u>\$ 2,600,065</u> | <u>\$ 2,477,251</u> |
| Daily weighted average number of subscribers | <u>33,197</u> | <u>31,746</u> | <u>33,013</u> | <u>31,559</u> |
| ARPU | <u>\$ 13.30</u> | <u>\$ 13.22</u> | <u>\$ 13.13</u> | <u>\$ 13.08</u> |

The table below illustrates the impact that the adoption of the new revenue standard had on ARPU for the three and six months ended June 30, 2018.

| | For the Three Months Ended June 30, 2018 | | | For the Six Months Ended June 30, 2018 | | |
|--|--|--------------------------------|--|--|--------------------------------|--|
| | As Reported | Impact of Adopting ASU 2014-09 | Balances Without Adoption of ASU 2014-09 | As Reported | Impact of Adopting ASU 2014-09 | Balances Without Adoption of ASU 2014-09 |
| Subscriber revenue, excluding connected vehicle services | \$1,112,652 | \$ 23,787 | \$ 1,136,439 | \$2,204,901 | \$ 48,179 | \$ 2,253,080 |
| Add: advertising revenue | 47,242 | — | 47,242 | 89,290 | — | 89,290 |
| Add: other subscription-related revenue | 165,058 | — | 165,058 | 305,874 | — | 305,874 |
| | <u>\$1,324,952</u> | <u>\$ 23,787</u> | <u>\$ 1,348,739</u> | <u>\$2,600,065</u> | <u>\$ 48,179</u> | <u>\$ 2,648,244</u> |
| Daily weighted average number of subscribers | 33,197 | 33,197 | 33,197 | 33,013 | 33,013 | 33,013 |
| ARPU | <u>\$ 13.30</u> | <u>\$ 0.24</u> | <u>\$ 13.54</u> | <u>\$ 13.13</u> | <u>\$ 0.24</u> | <u>\$ 13.37</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 June 30, | | For the Six Months Ended June 30, | |
|---|-------------------------------------|------------------|-----------------------------------|-------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Customer service and billing expenses, excluding connected vehicle services | \$ 89,335 | \$ 90,388 | \$ 177,068 | \$ 182,508 |
| Less: share-based payment expense | (1,077) | (1,029) | (2,141) | (2,040) |
| | <u>\$ 88,258</u> | <u>\$ 89,359</u> | <u>\$ 174,927</u> | <u>\$ 180,468</u> |
| Daily weighted average number of subscribers | 33,197 | 31,746 | 33,013 | 31,559 |
| Customer service and billing expenses, per average subscriber | <u>\$ 0.89</u> | <u>\$ 0.94</u> | <u>\$ 0.88</u> | <u>\$ 0.95</u> |

Free cash flow - is derived from cash flow provided by operating activities, net of additions to property and equipment and restricted and other investment activity. 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. 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 exclude from free cash flow certain items that do not relate to the on-going performance of our business, such as cash outflows for acquisitions, strategic investments and net loan activity with related parties. 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. 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 June 30, | | For the Six Months Ended June 30, | |
|---|-------------------------------------|-------------------|-----------------------------------|-------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Cash Flow information | | | | |
| Net cash provided by operating activities | \$ 531,226 | \$ 476,225 | \$ 922,615 | \$ 769,941 |
| Net cash used in investing activities | \$ (99,313) | \$ (606,862) | \$ (184,307) | \$ (667,248) |
| Net cash used in financing activities | \$ (446,255) | \$ (56,681) | \$ (743,227) | \$ (273,462) |
| Free Cash Flow | | | | |
| Net cash provided by operating activities | \$ 531,226 | \$ 476,225 | \$ 922,615 | \$ 769,941 |
| Equity-related transactions for Holdings ^(a) | 48,192 | 6,986 | 71,501 | 22,595 |
| Additions to property and equipment | (92,868) | (66,152) | (174,273) | (119,517) |
| Purchases of restricted and other investments | (307) | (334) | (7,138) | (7,355) |
| Free cash flow | <u>\$ 486,243</u> | <u>\$ 416,725</u> | <u>\$ 812,705</u> | <u>\$ 665,664</u> |

- (a) Subsequent to our corporate reorganization in November 2013, certain equity-related transactions are reported as related party transactions within our consolidated statements of cash flows. For the six months ended June 30, 2018 and 2017, this included payments of \$71,501 and \$22,595, respectively, for taxes paid in lieu of shares issued for stock-based compensation. These equity-related transactions are classified as Cash flows used in financing activities within Holdings' 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 promotional period 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 (excluding connected vehicle services), divided by the number of satellite radio installations in new vehicles and shipments of aftermarket radios for the period. The SAC, per installation, for the three and six months ended June 30, 2018 reflects adjustments as a result of adopting the new revenue standard as of January 1, 2018. SAC, per installation, is calculated as follows:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|-------------------------------------|-------------------|-----------------------------------|-------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Subscriber acquisition costs, excluding connected vehicle services | \$ 119,778 | \$ 125,154 | \$ 242,471 | \$ 252,642 |
| Less: margin from sales of radios and accessories, excluding connected vehicle services | (28,542) | (20,285) | (56,000) | (43,031) |
| | <u>\$ 91,236</u> | <u>\$ 104,869</u> | <u>\$ 186,471</u> | <u>\$ 209,611</u> |
| Installations | <u>3,313</u> | <u>3,362</u> | <u>6,693</u> | <u>6,946</u> |
| SAC, per installation | <u>\$ 27.54</u> | <u>\$ 31.19</u> | <u>\$ 27.86</u> | <u>\$ 30.18</u> |

The table below illustrates the impact that the adoption of the new revenue standard has had on SAC, per installation, for the three and six months ended June 30, 2018.

| | For the Three Months Ended June 30, 2018 | | | For the Six Months Ended June 30, 2018 | | |
|---|--|--------------------------------|--|--|--------------------------------|--|
| | As Reported | Impact of Adopting ASU 2014-09 | Balances Without Adoption of ASU 2014-09 | As Reported | Impact of Adopting ASU 2014-09 | Balances Without Adoption of ASU 2014-09 |
| Subscriber acquisition costs, excluding connected vehicle services | \$ 119,778 | \$ 800 | \$ 120,578 | \$ 242,471 | \$ 1,845 | \$ 244,316 |
| Less: margin from sales of radios and accessories, excluding connected vehicle services | (28,542) | — | (28,542) | (56,000) | — | (56,000) |
| | <u>\$ 91,236</u> | <u>\$ 800</u> | <u>\$ 92,036</u> | <u>\$ 186,471</u> | <u>\$ 1,845</u> | <u>\$ 188,316</u> |
| Installations | <u>3,313</u> | <u>3,313</u> | <u>3,313</u> | <u>6,693</u> | <u>6,693</u> | <u>6,693</u> |
| SAC, per installation | <u>\$ 27.54</u> | <u>\$ 0.24</u> | <u>\$ 27.78</u> | <u>\$ 27.86</u> | <u>\$ 0.28</u> | <u>\$ 28.14</u> |