SIRIUS SATELLITE RADIO INC
Form 10-Q
November 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

Commission file number 0-24710

SIRIUS SATELLITE RADIO INC.

(Exact name of registrant as specified in its charter)

Delaware	**52-1700207**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1221 Avenue of the Americas, 36th Floor
New York, New York 10020
(Address of principal executive offices)
(Zip code)

212-584-5100
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2).

Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).
Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, $0.001 par value	1,406,255,531 shares
(Class)	**(Outstanding as of November 3, 2006)**

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
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SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenue:				
Subscriber revenue, including effects of mail-in rebates	$ 155,337	$ 64,273	$ 408,154	$ 155,799
Advertising revenue, net of agency fees	7,130	1,508	22,593	3,094
Equipment revenue	3,579	1,030	10,367	3,300
Other revenue	1,067	20	2,741	48
Total revenue	167,113	66,831	443,855	162,241
Operating expenses (excludes depreciation shown separately below) (1):				
Cost of services:				
Satellite and transmission	7,580	7,695	34,279	22,164
Programming and content	79,532	28,397	462,511	78,382
Customer service and billing	14,915	9,556	44,863	27,051
Cost of equipment	6,196	1,453	13,128	4,381
Sales and marketing	49,083	47,823	152,257	137,891
Subscriber acquisition costs	79,812	81,029	329,418	235,576
General and administrative	35,053	20,103	103,261	64,664
Engineering, design and development	21,513	13,135	56,679	50,252
Depreciation	27,583	24,559	78,254	73,640
Total operating expenses	321,267	233,750	1,274,650	694,001
Loss from operations	(154,154)	(166,919)	(830,795)	(531,760)
Other income (expense):				
Interest and investment income	7,750	7,645	26,560	16,922
Interest expense, net of amounts capitalized	(15,921)	(13,693)	(48,705)	(28,219)
Loss from redemption of debt		(6,214)		(6,214)
Equity in net loss of affiliate		(739)	(4,445)	(739)
Other income	5	30	24	82
Total other income (expense)	(8,166)	(12,971)	(26,566)	(18,168)
Loss before income taxes	(162,320)	(179,890)	(857,361)	(549,928)
Income tax expense	(578)	(560)	(1,909)	(1,680)
Net loss	$ (162,898)	$ (180,450)	$ (859,270)	$ (551,608)
Net loss per share (basic and diluted)	$ (0.12)	$ (0.14)	$ (0.61)	$ (0.42)
Weighted average common shares outstanding (basic and diluted)	1,405,281	1,328,458	1,398,829	1,322,399

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(1) Amounts related to equity granted to third parties and employees included in other operating expenses were as follows:

Satellite and transmission	$ 490	$ 467	$ 2,202	$ 1,455

Programming and content	23,615	4,855	297,139	14,793
Customer service and billing	197	140	645	405
Sales and marketing	7,609	9,642	14,878	30,348
Subscriber acquisition costs	(1,051)	12,354	30,748	31,115
General and administrative	11,536	6,137	38,947	21,746
Engineering, design and development	1,022	3,351	10,734	17,020
Total equity granted to third parties and employees	$ 43,418	$ 36,946	$ 395,293	$ 116,882

See Notes to Unaudited Consolidated Financial Statements.

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	September 30, 2006	December 31, 2005
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 317,876	$ 762,007
Marketable securities	34,425	117,250
Accounts receivable, net of allowance for doubtful accounts of $2,899 and $1,550 at September 30, 2006 and December 31, 2005, respectively	17,291	31,688
Inventory	44,979	14,256
Prepaid expenses	64,432	18,248
Restricted investments	25,000	25,165
Other current assets	30,973	42,834
Total current assets	534,976	1,011,448
Property and equipment, net	833,599	828,357
FCC license	83,654	83,654
Restricted investments, net of current portion	58,300	82,450
Deferred financing fees	14,123	16,303
Other long-term assets	85,964	63,150
Total assets	$ 1,610,616	$ 2,085,362
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 314,242	$ 331,953
Accrued interest	13,083	23,546
Deferred revenue	314,080	251,468
Total current liabilities	641,405	606,967
Long-term debt	1,083,929	1,084,437
Deferred revenue, net of current portion	69,536	56,479
Other long-term liabilities	16,046	12,511
Total liabilities	1,810,916	1,760,394
Commitments and contingencies (Note 10)		
Stockholders equity:		
Common stock, $0.001 par value: 2,500,000,000 shares authorized, 1,405,667,870 and 1,346,226,851 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	1,406	1,346
Additional paid-in capital	3,386,417	3,079,169
Deferred compensation		(26,694)
Accumulated deficit	(3,588,123)	(2,728,853)
Total stockholders (deficit) equity	(200,300)	324,968
Total liabilities and stockholders equity	$ 1,610,616	$ 2,085,362

See Notes to Unaudited Consolidated Financial Statements.

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(In thousands, except share and per share amounts)
(Unaudited)

	Common Stock		Additional Paid-In Capital	Deferred Compensation	Accumulated Deficit	Total
	Shares	Amount				
Balances, December 31, 2005	1,346,226,851	$ 1,346	$ 3,079,169	$ (26,694)	$ (2,728,853)	$ 324,968
Net loss					(859,270)	(859,270)
Issuance of common stock to employees and employee benefit plans	19,885,673	20	19,535			19,555
Issuance of common stock to third parties	34,467,869	35	224,917			224,952
Compensation in connection with the issuance of stock-based awards			85,205			85,205
Reversal of deferred compensation related to the adoption of Statement of Financial Accounting Standards (SFAS) No.123R			(26,694)	26,694		
Exercise of options, $0.47 to $3.93 per share	2,764,476	3	3,785			3,788
Exercise of warrants, $2.392 per share	1,954,886	2	(2)			
Exchange of 3½% Convertible Notes due 2008, including accrued interest	368,115		502			502
Balances, September 30, 2006	1,405,667,870	$ 1,406	$ 3,386,417	$	$ (3,588,123)	$ (200,300)

See Notes to Unaudited Consolidated Financial Statements.

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	For the Nine Months Ended September 30,	
	2006	**2005**
Cash flows from operating activities:		
Net loss	$ (859,270)	$ (551,608)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	78,254	73,640
Non-cash interest expense	2,332	2,365
Provision for doubtful accounts	5,687	3,294
Non-cash loss from redemption of debt		712
Loss on disposal of assets	889	286
Impairment loss	10,917	
Equity granted to third parties and employees	395,293	116,882
Deferred income taxes	1,909	1,680
Changes in operating assets and liabilities:		
Marketable securities		16
Accounts receivable	8,710	(9,455)
Inventory	(30,723)	(5,413)
Prepaid expenses and other current assets	(34,564)	(14,613)
Other long-term assets	(21,674)	3,131
Accounts payable and accrued expenses	(70,974)	36,331
Accrued interest	(10,460)	6,341
Deferred revenue	75,669	81,805
Other long-term liabilities	(8,051)	(3,522)
Net cash used in operating activities	(456,056)	(258,128)
Cash flows from investing activities:		
Additions to property and equipment	(94,368)	(17,949)
Sales of property and equipment	123	65
Purchases of restricted and other investments	(5,700)	(6,291)
Release of restricted investments	25,000	10,997
Purchases of available-for-sale securities	(118,500)	(128,700)
Sales of available-for-sale securities	201,340	9,935
Net cash provided by (used in) investing activities	7,895	(131,943)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt, net		493,005
Redemption of debt		(57,609)
Proceeds from exercise of stock options	4,030	11,125
Other		(8)
Net cash provided by financing activities	4,030	446,513
Net (decrease) increase in cash and cash equivalents	(444,131)	56,442
Cash and cash equivalents at the beginning of period	762,007	753,891
Cash and cash equivalents at the end of period	$ 317,876	$ 810,333

Supplemental Disclosure of Cash and Non-Cash Flow Information				
Cash paid during the period for:				
Interest, net of amounts capitalized	$	56,952	$	19,511
Income taxes		472		134
Non-cash operating activities:				
Common stock issued in satisfaction of accrued compensation		7,243		4,824
Non-cash investing and financing activities:				
Common stock issued in exchange of 3½% Convertible Notes due 2008, including accrued interest		502		2,177
Common stock issued to third parties		224,952		

See Notes to Unaudited Consolidated Financial Statements.

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollar amounts in thousands, unless otherwise stated)
(Unaudited)

1. Business

We are a satellite radio provider in the United States. We currently broadcast 133 channels of programming to listeners across the country. We offer 69 channels of 100% commercial-free music and feature 64 channels of sports, news, talk, entertainment, traffic and weather for a monthly subscription fee of $12.95.

We broadcast through our proprietary satellite radio system, which currently consists of three orbiting satellites, 139 terrestrial repeaters that receive and retransmit our signal, a satellite uplink facility and our studios. Subscribers receive our service through SIRIUS radios, which are sold by automakers, consumer electronics retailers, mobile audio dealers and through our website. Subscribers can also receive our music channels and certain other channels over the Internet. As of September 30, 2006, we had 5,119,308 subscribers.

Our music channels are available to DISH satellite television subscribers and certain of our music channels are offered to Sprint subscribers over multi-media handsets. We also offer traffic and weather data services for a separate fee. Subscribers to DISH satellite television, Sprint and our traffic and weather data services are not included in our subscriber count.

In 2005, SIRIUS Canada Inc., a Canadian corporation owned by us, Canadian Broadcasting Corporation and Standard Broadcasting Corporation, received a license from the Canadian Radio-television and Telecommunications Commission to offer a satellite radio service in Canada. In December 2005, SIRIUS Canada launched service in Canada with 100 channels of commercial-free music and news, sports, talk and entertainment programming, including 10 channels of Canadian content. Subscribers to the SIRIUS Canada service are not included in our subscriber count.

2. Principles of Consolidation and Basis of Presentation

The accompanying unaudited consolidated financial statements of Sirius Satellite Radio Inc. and subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles and the instructions to Form 10-Q and Article 10 of Regulation S-X for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. All intercompany transactions have been eliminated in consolidation.

In presenting unaudited consolidated financial statements, management makes estimates and assumptions that affect the amounts reported and related disclosures. Estimates, by their nature, are based on judgment and available information. Actual results could differ from those estimates. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the consolidated financial statements as of September 30, 2006 and December 31, 2005, and for the three and nine months ended September 30, 2006 and 2005, have been recorded. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the full year. Our unaudited consolidated financial statements should be read together with our consolidated financial statements and footnotes contained in our Annual Report on Form 10-K for the year ended December 31, 2005.

3. Summary of Significant Accounting Policies

Revenue Recognition

Revenue from subscribers consists of subscription fees, including revenues associated with prepaid subscriptions included in the sale or lease price of a new vehicle; revenue derived from our agreement with Hertz; non-refundable activation fees; and the effects of mail-in rebates.

We recognize subscription fees as our service is provided to a subscriber. We record deferred revenue for prepaid subscription fees and amortize these prepayments to revenue ratably over the term of the respective subscription plan.

At the time of sale, vehicle owners purchasing or leasing a vehicle with a subscription to our service typically receive between a six month and one year prepaid subscription. We receive payment from automakers for

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued
(Dollar amounts in thousands, unless otherwise stated)
(Unaudited)

these subscriptions in advance of our service being activated. Such prepayments are recorded to deferred revenue and amortized to revenue ratably over the service period upon activation. We also reimburse the automakers for certain costs associated with the SIRIUS radio installed in the applicable vehicle at the time the vehicle is manufactured. The associated payments to the automakers are included in subscriber acquisition costs. Although we receive payments from the automakers, they do not resell our service; rather, automakers facilitate the sale of our service to our customers, acting similar to an agent. We believe this is the appropriate characterization of our relationship since we are responsible for providing service to our customers including being obligated to the customer if there was interruption of service.

Activation fees are recognized ratably over the estimated term of a subscriber relationship, currently estimated to be 3.5 years. The estimated term of a subscriber relationship is based on market research and management s judgment and, if necessary, will be refined in the future as historical data becomes available.

As required by Emerging Issues Task Force (EITF) No. 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products), an estimate of mail-in rebates that are paid by us directly to subscribers is recorded as a reduction to subscriber revenue in the period the subscriber activates our service. We estimate the effects of mail-in rebates based on actual take-rates for rebate incentives offered in prior periods, adjusted based on any current take-rate data available at the time. In subsequent periods, estimates are adjusted when necessary.

We recognize revenues from the sale of advertising on our non-music channels as the advertising is broadcast. 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. Advertising revenue includes advertising sold in exchange for goods or services (barter) recorded at fair value. Revenue from barter transactions is recognized when the advertising is broadcast and goods or services exchanged are received. Goods or services received are charged to expense when received and/or used. Barter transactions are not significant to our unaudited consolidated financial statements. We pay certain third parties a percentage of advertising revenue. Advertising revenue is recorded gross of such revenue share payments in accordance with EITF No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, as we are the primary obligor in the transaction. Advertising revenue share payments are recorded to programming and content expense during the period in which the advertising is broadcast.

Equipment revenue from the direct sale of SIRIUS radios and accessories is recognized upon shipment. Shipping and handling costs billed to customers are recorded as revenue. Shipping and handling costs associated with shipping goods to customers are recorded to cost of equipment.

EITF No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, provides guidance on how and when to recognize revenues for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. Revenue arrangements with multiple deliverables are required to be divided into separate units of accounting if the deliverables in the arrangement meet certain criteria. Arrangement consideration must be allocated among the separate units of accounting based on their relative fair values.

We determined that the sale of our service through our direct to consumer channel with accompanying equipment constitutes a revenue arrangement with multiple deliverables. In these types of arrangements, amounts received for equipment are recognized as equipment revenue; amounts received for service are recognized as subscription revenue; and amounts received for the non-refundable, up-front activation fee that are not contingent on the delivery of the service are allocated to equipment revenue. Activation fees are recorded to equipment revenue only to the extent that the aggregate equipment and activation fee proceeds do not exceed the fair value of the equipment. Any activation fees not allocated to the equipment are deferred upon activation and recognized as subscription revenue on a straight-line basis over the estimated term of a subscriber relationship.

Stock-Based Compensation

Effective January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), using the modified prospective transition method. Prior periods are not restated under this transition method. The stock-based compensation cost recognized beginning January 1, 2006 includes compensation cost for all stock-based awards granted to employees and members of our board of directors (i) prior to, but not vested as of, January 1, 2006 based on the grant date fair value originally estimated in accordance with

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued
(Dollar amounts in thousands, unless otherwise stated)
(Unaudited)

the provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and (ii) subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Compensation cost under SFAS No. 123R is recognized ratably using the straight-line attribution method over the expected vesting period.

SFAS No. 123R requires forfeitures to be estimated on the grant date and revised in subsequent periods if actual forfeitures differ from those estimates. Prior to the adoption of SFAS No. 123R we accounted for forfeitures as they occurred. For pro forma disclosure purposes in accordance with SFAS No. 123, we estimated forfeitures. As of January 1, 2006, the cumulative effect of adopting the estimated forfeiture method was not significant.

Prior to January 1, 2006, we used the intrinsic value method to measure the compensation cost of stock-based awards granted to employees and members of our board of directors in accordance with Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees. Accordingly, we recorded compensation expense for stock-based awards granted to employees and members of our board of directors over the vesting period equal to the excess of the market price of the underlying common stock at the date of grant over the exercise price of the stock-based award. The intrinsic value of restricted stock units as of the date of grant was amortized to expense over the vesting period. We accounted for modifications to stock-based awards in accordance with Financial Accounting Standards Board Interpretation (FIN) No. 44, Accounting for Certain Transactions Involving Stock Compensation. FIN No. 44 provided that when the modification of a stock-based award occured, a new measurement date resulted because the modification allowed an employee to vest in an award that would have otherwise been forfeited pursuant to the original terms. In accordance with FIN No. 44, we also recorded compensation charges or benefits related to repriced stock options based on the market value of our common stock until the repriced stock options were exercised, forfeited or expired.

The following table reflects net loss and net loss per share had stock-based compensation to employees and members of our board of directors been recorded based on the fair value method under SFAS No. 123 for the periods set forth below:

	For the Three Months Ended September 30, 2005	For the Nine Months Ended September 30, 2005
Net loss as reported	$ (180,450)	$ (551,608)
Stock-based compensation to employees and members of our board of directors	11,027	38,331
Stock-based compensation to employees and members of our board of directors pro forma	(22,066)	(72,617)
Net loss pro forma	$ (191,489)	$ (585,894)
Net loss per share:		
Basic and diluted as reported	$ (0.14)	$ (0.42)
Basic and diluted pro forma	$ (0.14)	$ (0.44)

Under SFAS No. 123R, we recognized $16,254 and $56,525 of compensation cost for stock-based awards granted to employees and members of our board of directors for the three and nine months ended September 30, 2006, respectively. Total unrecognized compensation related to unvested stock-based awards granted to employees and members of our board of directors at September 30, 2006, net of estimated forfeitures, is $117,936 and is expected to be recognized over a weighted-average period of three years.

Prior to January 1, 2006, we accounted for stock-based awards granted to non-employees, other than non-employee members of our board of directors, at fair value in accordance with SFAS No. 123. Effective January 1, 2006, we account for such awards at fair value in accordance with SFAS No. 123R and SEC guidance contained in Staff Accounting Bulletin (SAB) No. 107. The fair value of equity instruments granted to non-employees is measured in accordance with EITF No. 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. The final measurement date of equity instruments with performance criteria is the date that each performance commitment for such equity instrument is satisfied.

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued
(Dollar amounts in thousands, unless otherwise stated)
(Unaudited)

Stock-based awards granted to employees, non-employees and members of our board of directors generally include warrants, stock options, restricted stock and restricted stock units. Charges associated with such stock-based awards are referred to by us as equity granted to third parties and employees.

Upon adoption of SFAS No. 123R, we continued to estimate the fair value of stock-based awards using the Black-Scholes option valuation model (Black-Scholes). Black-Scholes was developed to estimate the fair market value of traded options, which have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions. Because our stock-based awards have characteristics significantly different from those of traded options and because changes in the subjective assumptions can materially affect the fair market value estimate, the existing option valuation models do not necessarily provide a reliable single measure of the fair value of our stock-based awards.

Fair value determined using Black-Scholes varies based on assumptions used for the expected life, expected stock price volatility and risk-free interest rates. For the nine months ended September 30, 2005, we used historical volatility of our stock over a period equal to the expected life of stock-based awards to estimate fair value. SAB No. 107 favors using a market value of volatility. We estimated the fair value of awards granted during the nine months ended September 30, 2006 using the implied volatility of actively traded options on our stock. We believe that implied volatility is more representative of future stock price trends than historical volatility. The expected life assumption represents the weighted-average period stock-based awards are expected to remain outstanding. These expected life assumptions are established through a review of historical exercise behavior of stock-based award grants with similar vesting periods. Where historical patterns do not exist contractual terms are used. The risk-free interest rate represents the daily treasury yield curve rate at the reporting date based on the closing market bid yields on actively traded U.S. treasury securities in the over-the-counter market for the expected term. Our assumptions may change in future periods.

The following table summarizes the weighted-average assumptions used to compute reported and pro forma stock-based compensation to employees and members of our board of directors for the periods set forth below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
		(pro forma)		**(pro forma)**
Risk-free interest rate	4.81%	4.12%	4.19%	4.05%
Expected life of options years	4.45	5.59	4.45	5.54
Expected stock price volatility	60%	112%	60%	112%
Expected dividend yield	N/A	N/A	N/A	N/A

The following table summarizes the range of assumptions used to compute reported and pro forma stock-based compensation to third parties, other than non-employee members of our board of directors, for the periods set forth below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Risk-free interest rate	4.59-4.99%	3.66-4.34%	4.29-5.23%	2.83-4.50%
Expected life of options years	2.50-9.73	1.00-9.27	1.67-10.00	1.00-9.45
Expected stock price volatility	60%	59-116%	60%	57-116%
Expected dividend yield	N/A	N/A	N/A	N/A

SFAS No. 123R changes the presentation of realized excess tax benefits associated with the exercise of stock options in the statements of cash flows. Excess tax benefits are realized tax benefits from tax deductions for the exercise of stock options in excess of the deferred tax asset attributable to stock compensation expense for such options. Prior to the adoption of SFAS No. 123R, such realized tax benefits were required to be presented as operating cash flows. SFAS No. 123R requires such realized tax benefits to be presented as part of cash flows from financing activities. No income tax benefits have been realized from stock option exercises during the three and nine months ended September 30, 2006 and 2005 because a valuation allowance was maintained for all net deferred tax assets.

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SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued
(Dollar amounts in thousands, unless otherwise stated)
(Unaudited)

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs for the three months ended September 30, 2006 and 2005 were $12,431 and $6,291, respectively, and $26,575 and $22,119 for the nine months ended September 30, 2006 and 2005, respectively. These costs are included in engineering, design and development expenses in our accompanying unaudited consolidated statements of operations.

Net (Loss) Income Per Share

We compute net (loss) income per share in accordance with SFAS No. 128, Earnings Per Share. Basic net (loss) income per share is calculated using the weighted average common shares outstanding during each reporting period. Diluted net (loss) income per share adjusts the weighted average common shares outstanding for the potential dilution that could occur if common stock equivalents (convertible debt, warrants, stock options and restricted stock units) were exercised or converted into common stock. Common stock equivalents of approximately 193,000,000 and 197,000,000 for the three and nine months ended September 30, 2006, respectively, and 239,000,000 and 235,000,000 for the three and nine months ended September 30, 2005, respectively, were not considered in the calculation of diluted net loss per share as the effect would have been anti-dilutive.

Comprehensive (Loss) Income

We report comprehensive (loss) income in accordance with SFAS No. 130, Reporting Comprehensive Income. SFAS No. 130 established a standard for reporting and displaying other comprehensive (loss) income and its components within financial statements. Unrealized gains and losses on available-for-sale securities are the only component of our other comprehensive loss. Comprehensive loss for the three months ended September 30, 2006 and 2005 was $162,898 and $180,450, respectively, and $859,270 and $551,584 for the nine months ended September 30, 2006 and 2005, respectively.

Marketable Securities

We account for marketable securities in accordance with the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Marketable securities consist of certificates of deposit and auction rate securities. The basic objectives of our investment policy are the preservation of capital, maintaining sufficient liquidity to meet operating requirements and maximizing yield. We classify our marketable securities as available-for-sale securities. Available-for-sale securities are carried at fair market value. Unrealized gains and losses are included in accumulated other comprehensive (loss) income as a separate component of stockholders equity. Realized gains and losses, dividends and interest income, including amortization of the premium and discount arising at purchase, are included in interest and investment income. The specific-identification method is used to determine the cost of all securities and the basis by which amounts are reclassified from accumulated comprehensive (loss) income into earnings. While the underlying securities of auction rate securities have contractual maturities of more than 20 years, the interest rates on such securities reset at intervals of 28 or 35 days. Auction rate securities are priced and subsequently trade as short-term investments because of such interest rate reset feature.

We received proceeds from the sale or maturity of marketable securities of $201,340 and $9,935 for the nine months ended September 30, 2006 and 2005, respectively. There were no unrealized holding gains or losses on marketable securities as of September 30, 2006 and December 31, 2005.

Restricted Investments

As of September 30, 2006 and December 31, 2005, short-term restricted investments of $25,000 and $25,165, respectively, primarily included certificates of deposit placed in escrow for the benefit of a third party pursuant to a programming agreement.

As of September 30, 2006 and December 31, 2005, long-term restricted investments of $58,300 and $82,450, respectively, primarily included certificates of deposit and money market funds deposited in escrow for the benefit of third parties pursuant to programming agreements and certificates of deposit placed in escrow to secure our reimbursement obligations under letters of credit issued for the benefit of lessors of office space.

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
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Property and Equipment

Property and equipment is stated at cost and depreciated on a straight-line basis over the estimated useful lives of the related assets, which range from 2 to 30 years. Our satellite system is depreciated on a straight-line basis over the respective remaining useful lives of our satellites from the date we launched our service in February 2002, or, in the case of our spare satellite, from the date it was delivered to ground storage in April 2002. Leasehold improvements and equipment under capital leases is depreciated using the straight-line method over the lesser of the lease term or the estimated useful life. 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 for the three and nine months ended September 30, 2006 were $1,134 and $2,532, respectively. We had no capitalized interest for the three and nine months ended September 30, 2005.

The expected useful lives of our three in-orbit satellites were originally 15 years from the date they were placed into orbit. In June 2006, we entered into an agreement with Space Systems/Loral to design and construct a new satellite. In connection with this agreement, we adjusted the useful lives of two of our in-orbit satellites to 13 years to reflect the way we intend to operate the constellation. We continue to expect our spare satellite to operate effectively for 15 years from the date of launch.

Our satellites have experienced circuit failures on their solar arrays. We continue to monitor the operating condition of our satellites. If events or circumstances indicate that the useful lives of our satellites have changed we will modify the depreciable life accordingly.

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset is not recoverable. At the time an impairment in value of a long-lived asset is identified, the impairment is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. To determine fair value, we employ an expected present value technique, which utilizes multiple cash flow scenarios that reflect the range of possible outcomes and an appropriate discount rate.

In connection with our new satellite agreement, in June 2006 we wrote-off $10,917 for the net book value of certain satellite long-lead time parts purchased in 1999 that we will no longer need.

Reclassifications

Certain amounts in the prior period unaudited consolidated financial statements have been reclassified to conform to the current period presentation, including the reclassification of equity granted to third parties and employees from a separate line item disclosure to being included in other operating expense line items in order to comply with the requirements of SFAS No. 123R.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. We do not believe the adoption of SFAS No. 157 will have a material impact on our consolidated results of operations or financial position.

In September 2006, the EITF issued EITF No. 06-1, Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider. The EITF concluded that if consideration given by a service provider to a third-party manufacturer or a reseller that is not the service provider s customer can be linked contractually to the benefit received by the service provider s customer, a service provider should account for the consideration in accordance with EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer. EITF No. 06-1 is effective for annual reporting periods beginning after June 15, 2007. We are currently evaluating the effects that EITF No. 06-1 will have on our consolidated results of operations and financial position.

In June 2006, the EITF issued EITF No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation), to clarify diversity in practice on the presentation of different types of taxes in the financial statements. The EITF concluded that for taxes within the scope of the issue, a company may include charges to customers for taxes within revenues and the charge for the taxes from the taxing authority within cost of sales, or, alternatively, it may net the charge to the customer and the charge from the taxing authority. If taxes subject to EITF No. 06-3 are significant, a

SIRIUS SATELLITE RADIO INC. AND SUBSIDIARIES
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company is required to disclose its accounting policy for presenting taxes and the amounts of such taxes that are recognized on a gross basis. EITF No. 06-3 is effective for the first interim reporting period beginning after December 15, 2006. We will adopt EITF No. 06-3 effective January 1, 2007. We do not believe the adoption of EITF No. 06-3 will have a material impact on our consolidated results of operations or financial position.

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, which prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, as well as criteria on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. We will adopt FIN No. 48 effective January 1, 2007. We do not believe the adoption of FIN No. 48 will have a material impact on our consolidated results of operations or financial position.

4. Subscriber Revenue

Subscriber revenue consists of subscription fees, non-refundable activation fees and the effects of mail-in rebates. Revenues received from automakers for prepaid subscriptions included in the sale or lease price of a new vehicle are also included in subscriber revenue over the service period.

Subscriber revenue consists of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Subscription fees	$ 153,192	$ 63,920	$ 407,203	$ 154,575
Activation fees	3,955	1,858	11,326	4,742
Effect of mail-in rebates	(1,810)	(1,505)	(10,375)	(3,518)
Total subscriber revenue	$ 155,337	$ 64,273	$ 408,154	$ 155,799

5. Interest Costs

During the three and nine months ended September 30, 2006, we capitalized a portion of the interest on funds borrowed to finance the construction and launch of our new satellite. The following is a summary of our interest cost:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest costs charged to expense	$ 15,921	$ 13,693	$ 48,705	$ 28,219
Interest costs capitalized	1,134		2,532	
Total interest costs incurred	$ 17,055	$ 13,693	$ 51,237	$ 28,219

6. Long-Term Debt

Long-term debt consists of the following:

	Conversion Price (per share)	As of September 30, 2006	As of December 31, 2005
$9\frac{5}{8}$% Senior Notes due 2013	N/A	$ 500,000	$ 500,000
3¼% Convertible Notes due 2011	$ 5.30	230,000	230,000
2½% Convertible Notes due 2009	4.41	300,000	300,000
3½% Convertible Notes due 2008	1.38	52,185	52,693
8¾% Convertible Subordinated Notes due 2009	28.4625	1,744	1,744
Total long-term debt			