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Investing

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Sirius Satellite Radio (SIRI:Nasdaq) is finally emerging from the shadow of faltering competitor **XM Satellite Radio** (XMSR:Nasdaq) .
A month ago, I suggested Sirius shares were being dragged down by concerns about XM's business. Since then, XM shares have fallen 28%, while Sirius has dropped just 4%.
There are differences between the managements of these two companies, and it is starting to appear in their share prices.

XM Stumbles

XM, which was first to market and had been the leader and a favorite of analysts, had to admit last week it's not going to meet its subscriber forecasts for either the current quarter or year. The company blamed slowing growth in the industry. Sirius, however, reaffirmed its guidance to add about 550,000 new subscribers in the current quarter and to surpass 6.2 million subs for the full year.
While XM still expects to increase its subscriber numbers by more than 40% in 2006, Sirius' projections are for annual growth of 88%. Although Sirius' growth is off a smaller base, it's clear Sirius is showing more robust growth now. It is also gaining market share.
It is puzzling that XM is having difficulty this quarter, given that the baseball season is in full swing and XM offers broadcasts of all the games. Major League Baseball has provided a spring boost to XM in the past. When XM reduced its numbers, it cited softness in the industry. But when you are one of only two companies in a market and the other player isn't seeing softness, one must surmise that something else is going on here.

XM's Perfect Storm

XM's problems have intensified in recent weeks: The Federal Trade Commission has complained about some of the company's marketing practices; the Federal Communications Commssion is investigating complaints that the signals from some of XM's radio models interfere with reception of terrestrial radio broadcasts; and a director loudly quit earlier in the year, suggesting many problems loomed for the company.
Also, over the past month, more than a dozen class-action lawsuits have been filed against XM concerning stock sales by its CEO during the fourth quarter, and XM's public statements that its subscriber-acquisition costs would continue declining in the fourth quarter and in 2006. Far from falling, the subscriber-acquisition costs rose dramatically because of XM's decision late in 2005 to sell radios at **Wal-Mart** for a rock-bottom $29 in a futile attempt to thwart gains at Sirius sparked by the upcoming debut of Howard Stern.
Last week, a few Wall Street analysts who were diehard supporters of XM turned sour on the company because they believe XM's management has lost its credibility. That pushed XM to a low Thursday of $12.77. It bounced back to $14.31 Friday and was a bit higher Tuesday.

More than 50 million shares traded hands Thursday and Friday -- that number is a sixth of its total share base. My guess is that probably flushed out almost everyone who might have been thinking of selling XM, but it may be that many switched to Sirius, which was up almost 15% on Thursday and is now back to $4.50 after hitting a low of $3.60 last week.

Also last week, Stern settled with CBS over accusations that he wrongly used the last 15 months of CBS broadcasts to promote his move to Sirius. Stern paid $2 million to acquire the rights to all 10,000 hours of tape of his CBS shows.

Strong Growth Ahead for Satellite Radio

Many question if people will actually pay to receive radio signals, but Sirius and XM are growing rapidly; they already have a combined 10 million paying subscribers and expect to surpass 15 million by the end of the year. Both companies assert they will be cash-flow positive in the fourth quarter of this year and for all of 2007. (XM's projections don't include capital expenditure charges for satellites to be launched later this year; Sirius' numbers include reserves for launching satellites in 2010.)

Some analysts fret about how the two companies book their sales through tie-ups with the auto industry, particularly who is a paying subscriber and when that subscriber should be counted. What they don't understand is that the car manufacturers have struck different deals. Some include a free year in the sticker price of the car; others include 90 days.

XM and Sirius *must* report the subscription income at the time they are paid by the auto manufacturer, even if the car hasn't yet been sold. Sirius, for example, books that income as deferred revenue until the subscription is actually activated by the end customer. (It has exclusive relationships with **Ford**, **DaimlerChrysler** and **BMW**.)

Sirius seems to be making better business decisions, and until XM's tsunami of bad news subsides, I prefer Sirius as a long-term investment.

At the time of publication, Lappin was long Sirius, although holdings can change at any time.

Joan Lappin, CFA, is chairman and chief investment officer of Gramercy Capital Management Corp., a registered investment advisor based in New York City, which she founded in 1986.

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