S&P Global
Market Intelligence

Sirius XM Holdings Inc. NasdaqGS:SIRI

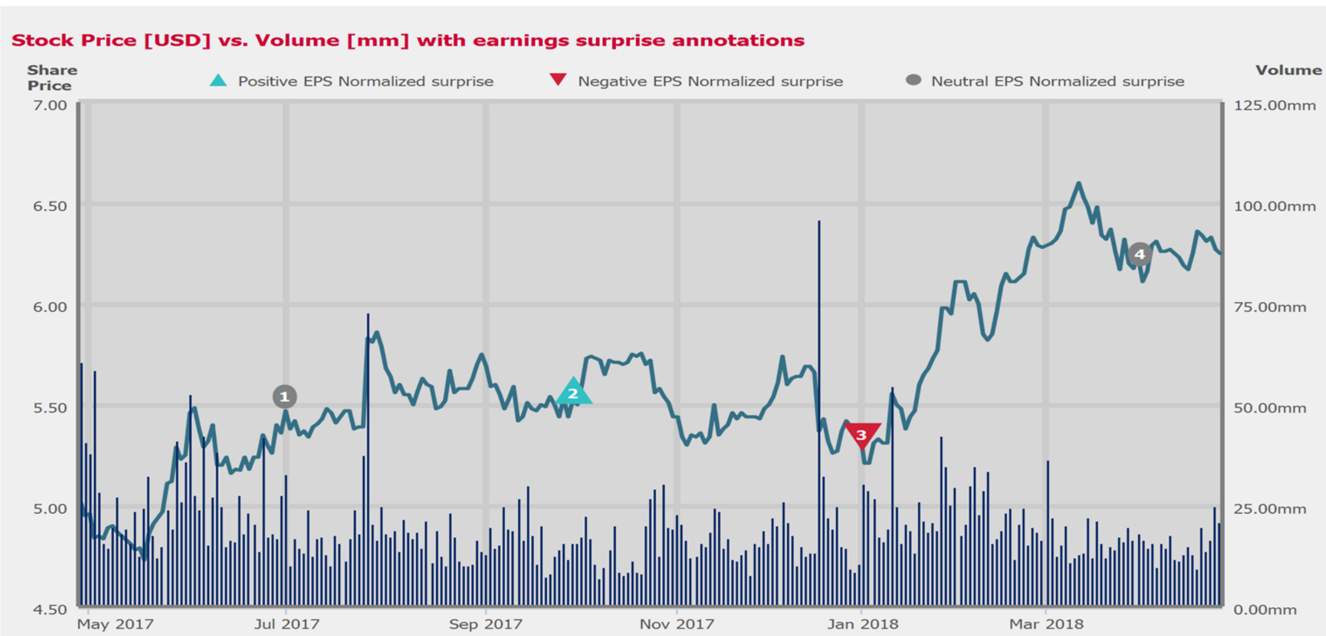
FQ2 2018 Earnings Call Transcripts

Wednesday, July 25, 2018 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.06	0.06	0.00	0.06	0.23	0.27
Revenue (mm)	1420.33	1432.30	0.84	1455.27	5742.62	6082.75

Currency: USD
Consensus as of Jul-24-2018 11:06 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	0.04	0.04	0.00 %
FQ3 2017	0.04	0.07	75.00 %
FQ4 2017	0.05	0.03	(40.00 %)
FQ1 2018	0.06	0.06	0.00 %

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EXECUTIVES

David J. Frear
Senior EVP & CFO

Hooper Stevens
Vice President of IR & Finance

James E. Meyer
CEO & Director

Scott A. Greenstein
President and Chief Content Officer

ANALYSTS

Barton Evans Crockett
B. Riley FBR, Inc., Research Division

Benjamin Daniel Swinburne
Morgan Stanley, Research Division

Brett Joseph Feldman
Goldman Sachs Group Inc., Research Division

Brian Wayne Russo
Crédit Suisse AG, Research Division

Jason B Bazinet
Citigroup Inc, Research Division

Jessica Jean Reif Cohen
BofA Merrill Lynch, Research Division

Steven Lee Cahall
RBC Capital Markets, LLC, Research Division

Presentation

Operator

Good morning, and welcome to SiriusXM Second Quarter 2018 Results Conference Call. Today's conference is being recorded. [Operator Instructions] At this time, I would like to turn the call over to Hooper Stevens, Senior Vice President, Investor Relations and Finance. Mr. Stevens, please go ahead.

Hooper Stevens
Vice President of IR & Finance

Thank you, and good morning, everyone. Welcome to SiriusXM's Second Quarter Earnings Conference Call. Today, Jim Meyer, our CEO, will be joined by David Frear, our Senior EVP and CFO. At the conclusion of our prepared remarks, management will be glad to take your questions. Scott Greenstein, our President and Chief Content Officer, will also be available for the Q&A portion of the call.

First, I'd like to remind everyone that certain statements made during the call might be forward-looking statements as the term is defined in the Private Securities Litigation Reform Act of 1995. These and all forward-looking statements are based on management's current beliefs and expectations. And of course, they necessarily depend upon assumptions, data or methods that may be incorrect or imprecise. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. For more information about these risks and uncertainties, please view SiriusXM's SEC filings. We advise listeners to not rely unduly on forward-looking statements and disclaim any intent or obligation to update them.

As we begin, I'd like to advise and remind our listeners that today's results will include discussions about both actual results and adjusted results. All discussions of adjusted operating results exclude the effects of stock-based compensation.

I'll now hand the call over to Jim Meyer.

James E. Meyer
CEO & Director

Thanks, Hooper. Good morning, and thank you for joining us to discuss the quarter. SiriusXM's long track record of success continued in the second quarter. And we are performing better today than we ever have as a team. We are pushing our people to constantly improve, informing our decisions with more and better data than ever before. And you can clearly see the impact in our results.

With the strong second quarter, we are increasing our 2018 guidance for growth in self-pay subscribers, revenue and EBITDA. I'm thrilled SiriusXM was able to add nearly a 0.5 million self-pay subscribers this quarter and achieve our lowest-ever self-pay churn rate of just 1.6%. Conversion performance was also strong. Self-pay subscribers exceeded 28 million for the first time ever and our total paid subscriber base reached a record 33.5 million.

There is, without a doubt, a tailwind from the growing economy that benefits us. Employment is strong, wage growth is picking up and auto sales continue to be robust. But our subscriber performance is more than anything else a ringing endorsement of our value proposition and our differentiated content offering. It is further a result of us continually improving operational processes and keeping a tight focus as we execute our plan. Despite all these successes, candidly, I still see many areas in which we can continue to improve. And I'll get more into that in a bit.

The new vehicle SAAR was 17.1 million in the second quarter, up 2% from last year. Our penetration rate remains right at about 3/4. And frankly, our OEM relationships continue to deepen and strengthen. In the second quarter, we extended our Nissan and Kia agreements for another 5 years. And we are, as is typical, working on several additional OEM extensions. With some of these extensions, we anticipate OEMs committing to even higher long-term penetration rates.

Our used car business continues to grow and will provide a long-term tailwind to growth as penetration moves from approximately 38% today towards our new car penetration of 75%-plus over the next decade. We are now offering trials at approximately 33,000 dealers, up by about 5,000 from this time last year. We still have room to improve our distribution here. But it does get harder as we move into smaller independent dealers.

Growing the trial funnel is very important. But the quality of these trials could be improved. And here, I think, is one of the areas where we can execute better. As part of our fieldwork, we are finding far too many used cars on dealer lots that have not been properly activated at the time of sale. We are investing time and resources to ensure that more vehicles are properly activated before a customer drives off the lot.

We'll also keep working to improve our efforts in the private sale market, where we will see big gains in penetration over the coming years. Our distribution in Service Lane and other third-party service organizations is bearing substantial fruit and helps address this market. And many more efforts are underway. Quite frankly, all of this stuff is hard work. But these challenges are solvable and we are well on our way.

We launched 360L with Fiat Chrysler in the second quarter. And we are continuing to aggressively push the rollout schedule of 360L across multiple OEMs over the coming years. Distribution of 360L will expand by a significant degree next year and beyond. This new platform, the marriage of satellite and IP, vastly enhances our capabilities in connected vehicles both in terms of the consumer feature set and our ability to market to, convert and retain those subscribers. I am thoroughly convinced that 360L is a key strategic advantage for us.

Let me be crystal clear. Connectivity is a thrilling positive for our business. I love that we now have unlimited channel capacity. We can use Return Path data to better understand our subscribers' preferences, surface new and interesting content in a more personalized experience and help our subscribers take that same learning and growing experience with them as they listen or even watch on mobile or other connected devices.

And by understanding behavior in trial and beyond, we will sharpen our marketing and make it more relevant to our potential and existing customers. This is an area we can still vastly improve. The ability to transact in the car reduces friction in our subscriber relationships and will help with both retention and up-selling. And oh, by the way, it also helps reduce our costs as more customer interactions are handled digitally.

Our relationships with many of the OEMs is complemented and enhanced by our growing connected vehicle service business, which provides safety, security and convenience features to consumers on behalf of OEMs. This business, while small compared to our audio business, is now seeing strong double-digit growth in units, revenue and EBITDA. It also deepens the touchpoints between Sirius and the OEMs and gives us clear visibility in the direction of future vehicle technology platforms. We told you that building the connected vehicle service business would take time and it did. But now the momentum is clear. And we believe this growth will continue for years to come.

Streaming is another area we are working hard to improve. In May, we launched our completely redesigned app for Android and iOS, which brings our streaming users a vastly improved user interface, more search and discovery functions, and for the first time ever, video content, and specifically Howard Stern. The response from our users has been excellent with engagement climbing and strong ratings in the app stores.

By making the app easier to use, we have increased on-demand listening by more than 60%, just one small example of improved engagement. The response to video has far exceeded my expectations with millions of plays already in a very short period of time. Over time, we will layer in live video of Howard's show and more video generated by our universe of talented hosts and guests.

The new and improved app is part of a major push to drive engagement with SiriusXM outside of the car, which we think enhances our value proposition and will make subscriber relationships richer and stickier.

To that end, we are seeing substantial growth in usage on connected devices like Amazon's Alexa. We have already launched on most major connected platforms. And we are improving the 10-foot SiriusXM user experience on smart TVs.

Over time, you will see focus more on winning over potential subscribers who do not have a need or desire for an in-car plan. Today, subscribers without an in-car plan are a very small portion of our business. But I am optimistic that with the right marketing approach and distribution arrangements, our content assets will be very appealing to a large number of potential out-of-car subscribers.

And speaking of content, as always, we are steadfastly focused on finding, acquiring and developing the best music, talk, entertainment, sports and comedy programming in all of audio. We know our subscribers are busy. And we want our bundle to offer the best, most compelling, most informative and fun programming we can find. It's nice when we can work with the best content creators in media.

Last week, we announced our agreement with Netflix to create, curate and launch a full-time comedy channel with the streaming service. It will be fueled by their world-class comedy programming from top global talent and include original programming made just for the SiriusXM channel. Comedy is important to us as a differentiator and because we know that listeners love it as part of their bundle of diverse programming.

In the last few months, we have also launched music channels devoted to U2, Dave Matthews Band, The Beach Boys and Fleetwood Mac and brought our listeners exclusive performance from such pop stars as Shawn Mendes in Los Angeles, country's Jason Aldean in New York City and the incomparable U2 playing for our subscribers at Harlem's Apollo Theater. We also broadcast live from major music festivals, such as Coachella, Stagecoach and New York City's Governors Ball.

During the quarter, we also gave sports fans access to the biggest events, such as the NFL Draft, the Masters, the Indianapolis 500, the World Cup and every step of Justify's ride to the Triple Crown. We recently added a new show by pro golfer and entrepreneur Greg Norman, which focuses on golf and business. We also bolstered our news presence by adding veteran journalist Olivier Knox as our new chief Washington correspondent on SiriusXM's P.O.T.U.S. channel. Olivier is also the new President of the White House Correspondents' Association. Good luck on that, Olivier. I don't need to tell you our news team never has a slow day.

Our content is at the heart of our business. And we really work hard to keep it special. Combining this great content with an easy-to-use service in and out of the car is a winning combination, as 33.5 million paying subscribers would attest. High and growing rates of monetization, consistent trial conversion rates and low churn are all evidence of this unique value proposition.

And our business model, we think, remains the best in media, with high variable margins, strong cash conversion, a steady record of performance and a path to long-term growth. Despite increased investments across all our business, including peak payments for new satellites this year, substantially higher music royalties and a $150 million settlement with SoundExchange, we still expect to deliver $1.5 billion of free cash flow this year.

We will continue to be opportunistic and disciplined as we evaluate areas for further investments, potential acquisitions, and of course, capital return to our shareholders. Needless to say, I am very proud of what our team accomplished in the second quarter. But we still have much work to do this year to achieve our new, higher operational and financial targets. That said, I am very comfortable with our increased guidance and look forward to delivering more exceptional results for you later this year.

With that, I'll turn it over to David.

David J. Frear
Senior EVP & CFO

Thanks, Jim. Good morning, everyone, and thanks for joining the call. Our fast start to 2018 accelerated in the second quarter with 483,000 self-pay net adds in the quarter and the lowest-ever self-pay churn rate of 1.6% are a remarkable testament to the demand and quality of our offering.

As of today, over 33% of the cars in the country are enabled with SiriusXM Radio, roughly 112 million vehicles, up 11% from a year ago. While this took many years of hard work that we're proud of, our focus remains on the 80% growth in the enabled fleet we expect as we arc towards 200 million vehicles over the next decade.

New car sales grew 2% in the quarter while our penetration rate of 75% was in line with our expectations. This lifted new vehicle trial starts 2% to 3.4 million while used car trial starts grew to -- over 10% to 2.4 million, both of which are record highs, resulting in total trial start growth of over 5% to about 5.8 million. At the end of the quarter, the total trial funnel stood at over 9.3 million, the highest it's ever been.

Our 483,000 self-pay nets in the quarter brought the self-pay base to 28.2 million. Total nets in the second quarter were 429,000 as paid trials declined 54,000, resulting in a total paid subscriber base of 33.5 million. Solid new car conversion rates of 39% and used car rates in the high 20s remained steady in the quarter and also contributed to self-pay subscriber growth. Based on this performance, we're taking our full year guidance up to approximately 1.15 million self-pay net subscriber additions.

ARPU of $13.30 grew 1% in the quarter or 2% excluding the $0.24 headwind due to the new revenue recognition standard, which became effective January 1. With the strength of our subscriber growth, in addition to continued strong advertising growth of 18% and equipment revenue growth of 24%, total quarterly revenue increased more than 6% to over $1.4 billion or 8% when you exclude the effect of the new accounting standard. With more than half the year under our belt, we're increasing our full year revenue guidance to over $5.7 billion.

Contribution margin in the quarter was 69.5%, down nearly 1 point versus the second quarter of last year with lower customer service and billing expenses as a percentage of revenue and the accounting change, partially offsetting higher revenue share and royalty expenses resulting from last December's CRB decision. We also settled long-standing litigation with SoundExchange. As we booked charges to reserve for this settlement in prior periods, the second quarter impact to the P&L for this expense totaled $69 million, which is excluded from our adjusted EBITDA guidance.

SAC in the quarter declined from Q2 '17 due to reductions in OEM hardware subsidy rates and lower chipset cost as we continue to roll newer technologies through automotive production. There was also a small decrease in the volume of installations resulting in SAC per install of less than $28. As the business grows, we continue to get a margin benefit and the SAC of $120 million was just 8.4% of revenue, a record low.

Adjusted EBITDA grew 4% to $543 million, a second quarter record even with the benefit of new MRF revenue in its early stages, and produced an adjusted EBITDA margin of 37.9% in the quarter. Based on this performance, we feel confident enough to take our full year adjusted EBITDA guidance up to approximately $2.175 billion.

In the second quarter, we converted 89% of our adjusted EBITDA into free cash flow totaling $486 million, up 17% year-over-year, despite capital expenditures stepping up to $93 million in the period versus $66 million in the second quarter of 2017. We remain confident in achieving our full year cash flow guidance of approximately $1.5 billion.

It's important to note that this free cash flow guidance is inclusive of $150 million one-time payment related to the settlement of long-standing litigation with SoundExchange that was paid early in the third quarter. And this relates to that $69 million charge I talked about. But for this payment, we would likely be increasing our free cash flow guidance, as cash generation from the business is running ahead of our prior guidance.

Second quarter net income was also impacted by an $86 million unrealized gain associated with the change in fair value of our Pandora investment. Our second quarter and first half book tax rates were 19% and 21%, respectively, lower than expected because of benefits associated with stock-based comp and a rising share price. Our long-term tax rate should be approximately 24%, absent further such benefit. We expect to begin paying federal cash taxes in 2021.

In the second quarter, we spent $22 million to repurchase approximately 3.6 million shares and paid nearly $50 million in dividends to stockholders. Total debt now stands at approximately $6.4 billion with no bond maturities until August 2022. At the end of our quarter, our debt-to-adjusted EBITDA was just 3x. We had cash on hand of approximately $64 million. Our revolving credit facility, which we recently extended to 2023, is completely undrawn with a capacity of $1.75 billion. This gives us ample liquidity to continue to invest in our business, make strategic investments and return capital to stockholders.
And operator, let's open it up for questions.

Question and Answer

Operator

[Operator Instructions] And your first question will come from Jason Bazinet with Citi.

Jason B Bazinet
Citigroup Inc, Research Division

You guys had a really good quarter. The only thing that just stood out to me was the relatively low buyback relative to what's in our model. I was just wondering if you could provide a little bit of color on that. I have to go back, I think, 4 or 5 years in our model to the time when you bought less.

David J. Frear
Senior EVP & CFO

So yes, I mean, it's -- look, if the toughest thing that we have to talk about in the quarter is that we had outstanding stock performance and it ran through our grid. It's kind of like a first-world problem. But that's exactly what it did, that there was a -- we had a big event in December with the tax law change. And we revised the grid to reflect that, bought a lot of stock between the passing of the tax law and the time of the earnings call. And we revised the grid, again put it into place as we went into the second quarter. And honestly, the performance of the stock just caught us flat-footed. And it's not one of these things where you yank the grid back every time the stock goes on a run. And so we've had great performance in stock, we're thankful. We continue to think that the stock is a good value. And so that's what it is.

Operator

And your next question will come from Brett Feldman with Goldman Sachs.

Brett Joseph Feldman
Goldman Sachs Group Inc., Research Division

Actually, just to follow up on that one, have you adjusted the grid going forward, meaning you're now going to be able to maybe be more active based on where the share price is? Or is that not what you were trying to communicate?

David J. Frear
Senior EVP & CFO

We've never talked about what we're going to do with buyback on a forward-looking basis in the past and we won't do that today.

Brett Joseph Feldman
Goldman Sachs Group Inc., Research Division

Okay, fair enough. And then an operating question, the churn was obviously a stand-out metric in the quarter. I know that it can ebb and flow and it's not always easy to understand exactly why it moves from quarter-to-quarter. But if you have any thoughts as to why you ebb down and the durability of it, that would be interesting. And you did note that installations were down. And I guess that's actually kind of one of the positives of low churn, you don't have to spend as much to acquire customers. I'm wondering if any of that was intentional or if these things just kind of move in those directions this quarter.

James E. Meyer
CEO & Director

No, I think, number one, most of the improvement -- so the question you asked is the same one I asked, which, is 1.6% the new normal. I'll be clear with you, I don't believe it's the new normal. I believe we performed as well as you can perform in the second quarter. That said, there are a lot of building blocks.

And by those, I mean lots of things that are just simple hard work, blocking and tackling, that led to improvements in the performance that we would hope to see flow through over the coming quarters. And we've always said that you should think of our churn between 1.8% and 2%. I'm not ready to say that's not the way you should think about it. But we'll continue to look at the performance in the second quarter as we move into the third and fourth and see how it goes. I will remind you that our churn does include the turnover of vehicles. And as that turnover continues to increase and increase, it puts pressure in that number. And you need to remember that when you're thinking about our overall churn number as well.

David J. Frear
Senior EVP & CFO

So let me just add 2 things, that the voluntary and nonpaid churn, which we talked about in prior calls, was sort of an extraordinary number in the quarter. It was under 1.2%. And we've never seen it at that level before. And it would be great if it continues. I think part of that is a testimony to the health of the U.S. economy. On the installations front, you mentioned that, the installations were down, I think, only like 1% or 1.5% in the quarter. It wasn't very much. And so it doesn't really contribute all that much to lower SAC. Most of the lower SAC is associated with the change-out in technologies in the cars and is in fact sustainable. The installations do bounce around a little bit. So we had a little bit of an inventory contraction in essence in the quarter. But it was fairly small.

Operator

And we will now hear from Brian Russo with Crédit Suisse.

Brian Wayne Russo
Crédit Suisse AG, Research Division

It looks like your guidance raise for net adds was mostly passing through the beat this quarter. So I wanted to ask, for the first half of this year, it seems that the auto sales in the country have done a lot better than initially expected. Are you getting a sense of optimism from your OEM partners for the remainder of the year? Or are people kind of still cautious that we have a ways to go before the book on 2018 is written?

James E. Meyer
CEO & Director

So I think -- this is Jim. I think we certainly, when we went into the second quarter, heard quite a bit of optimism from the automakers. And as you know, they're booked out pretty far in terms of their build plans and their capacity. I will say there is a lot of noise, as you well know, on the trade front. And no one quite knows how that's going to work out and where that will go. And so if you ask me, are there any things that are out there that are hard to gauge? I would say for me, and I would say the auto companies, that's the biggest one. Every auto company, I think, is on record in Washington of some type of a modification to the trade, the trade proposals that the President has put in place. We'll just see where it goes out. And frankly, I have no idea what will happen there.

Operator

And our next question will come from Ben Swinburne with Morgan Stanley.

Benjamin Daniel Swinburne
Morgan Stanley, Research Division

Jim, historically, when you guys have raised prices, you've either -- you've had to manage churn or you've seen some impact to churn. And I realize this is 1 quarter. But it looks like you could extrapolate out the first half of the year to suggest you guys have more pricing power maybe than people expected. And I'm certainly not encouraging you to raise prices more as a consumer. And I know you're careful on that front. But I'm just wondering, I'd love to hear what you think is going on in the business today around price increases and the impact to churn and customer satisfaction versus your experience in prior periods, when you've been raising prices.

James E. Meyer
CEO & Director

So Ben, I think you ask me that question -- this will be the fifth year as CEO you've asked me. I have to tell you, I was little surprised, to be very candid with you, to the reaction in the second quarter. We had built in, I think, more reaction to the increase in the MRF than we saw. I'm not bold enough to tell you that I'm willing to use that as a barometer to predict how much pricing power we have. And I can tell you we constantly deal with subscribers who are very volatile. I will also tell you though, we appear to have a large group of subscribers who are extremely satisfied with our service and have stayed with us through certainly this MRF increase with very little disruption. So I've got to tell you, it's a real positive and a real testament to our value proposition.

Benjamin Daniel Swinburne
Morgan Stanley, Research Division

And then just a second question. Years ago, we used to...

James E. Meyer
CEO & Director

Ben, that said, we're going to continue to be really, really cautious here going forward.

Benjamin Daniel Swinburne
Morgan Stanley, Research Division

Understood. We used to be very focused years ago on your OEM renewals and sort of what was moving around there. We don't get as much information anymore. But I'm just curious, at least qualitatively or strategically, now that you're doing, I don't know, what are maybe the fourth or fifth cycle deals with these car partners, what's new? What are you focused on? Is there anything that we might see in your results as a result of these agreements, which are now kind of routine and in the background but obviously are incredibly important to your business?

James E. Meyer
CEO & Director

So I think -- it's a great question. And I think there's kind of 4 things to talk about there. Probably the biggest headline, first and foremost, is their enthusiasm for including satellite radio in their vehicles. And I've been here a long time. And at the very beginning, this was a hard sell to get them to put them in. I think now the automakers are feeling pretty significant pull from the consumer that satellite radio is an expected feature in the vehicles. And so as we're renewing these agreements, as I said in my comments, there are certainly some automakers who are indicating that they would be interested in some increased levels of penetration. We don't have those done yet. We'll continue to work our way through that. Second, and you heard it in David's comment a couple moments ago, in all of these agreements, it's very important that they include commitments from the automakers to transition to our new platforms. That's really important for 2 reasons. One, it involves our best -- frankly, our best experience for the customer. That was what we called the XMH platform several years ago, which is now -- that transition is finally complete. That would now be 360L. And in each commitment, as we renew with OEMs, 360L is clearly right upfront and how fast they can go and what can we do to help them with the speed of that implementation. But as importantly, it's lower cost. And our new platforms continue to be lower and lower cost. And you're seeing that in our SAC, which David pointed out. And then finally, the OEMs clearly understand that this is a long-term gain and that it's providing good customer satisfaction for their customers. And so I think we're just seeing -- I have to tell you, we're seeing very positive things all along the way.

Operator

We will now move to Steven Cahall with RBC.

Steven Lee Cahall
RBC Capital Markets, LLC, Research Division

So I just had a question on ARPU. If I disaggregate your ARPU a little bit, I think your sub ARPU is running down a little bit year-on-year, a couple of percent. And then the ad ARPU has been really strong, I think it's up low double digit both for the half year and for the quarter. So could you just give us maybe a little bit of color on how you see the subscriber pricing model? And do you think that's a deflationary aspect of the business? And then flip side on the advertising, which has been really strong or the other ARPU driver that's been really strong, can you give us some color as to how those trends are looking?

David J. Frear
Senior EVP & CFO

Sure. So on the subscriber revenue side, we did have the accounting change, which hit $0.24. So I think if you adjust that out, you have a different trend, right? Because it retarded growth in ARPU by $0.24. And the advertising guys have been knocking the cover off the ball for a good long time now, that 18% ad revenue growth is something that you just -- outside of the big digital guys, you just don't see. And Scott, I don't know if you want to comment on the ad revenue growth.

Scott A. Greenstein
President and Chief Content Officer

Yes. Look, as we all know, the ad market is volatile and all over the place and will continue in my opinion to be so. But we're providing unique content with a very sticky subscriber base that's a very desirable base to advertise to. So I think that combination is being, as silly it sounds, discovered more and more by the ad community and they're getting results. So they're definitely there and coming. But again, the ad market is subject, like most things. But in particular, there are a lot of changes out there that could affect us. But right now, we're happy with the position we're in.

Steven Lee Cahall
RBC Capital Markets, LLC, Research Division

Could you give us any indication of what the pricing trend has been in advertising?

James E. Meyer
CEO & Director

I don't think -- we don't give that. We haven't really discussed that. Obviously, if you look at the strength in our revenue growth, we're clearly seeing strength everywhere.

David J. Frear
Senior EVP & CFO

Yes, it's not just more spots for us. We have been able to secure increases in rates.

Scott A. Greenstein
President and Chief Content Officer

Yes, we're not in -- our primary focus will always be the consumer and subscriber experience on air. It's never about, "Can we fit in a few more spots at the expense of a listening experience?"

Operator

And your next question will come from Jessica Reif with Bank of America Merrill Lynch.

Jessica Jean Reif Cohen
BofA Merrill Lynch, Research Division

I have three questions. One is you're so far below your target leverage at currently at 3x. I think the target is 4. You've got significant free cash flow. Your buyback, as you mentioned, has already slowed down a bit. Can you talk about investment in other businesses? You've kind of taken a stab at iHeart, maybe that's over. There's been speculation that something will happen with Live Nation. Could you talk about what assets would bring added value to the company? My second, it sounds like you've redefined your target market with out of the car. Can you talk about how you'll charge for that and how big a market your target market is now? And then finally, on the video results, which now clearly positive, how do you measure success? And can you talk about your rollout plans for other video services?

James E. Meyer
CEO & Director

So Jess, it's Jim. Let me start with the first question. So we've been talking about this for a long time. And I think I've been really clear. I think we look at everything when we evaluate what are we going to do with the capital that we're generating from our business. And as you know, we have what I think is a very, very nice basket, which is I believe we are investing in all of the key areas in our business that we need to, first and foremost. We're growing the connected vehicle business as we speak. And I'm certainly on the prowl, for looking for other things there that could fit with us. Automatic Labs a year ago is a good example of that. And we continue to look. Keep that in mind, I'm going to comment back, that in a moment. And then we've invested in Pandora. Obviously, there was a fair amount of activity around iHeart, which has now since ceased. I don't have any comment on Live Nation. I'm not even quite sure where some of that speculation is coming from. It's not coming from SiriusXM, but -- and by the way, I will tell you, Michael Rapino is a board member of SiriusXM. I'm thrilled to have Michael on our board. We have, I think, growing and strong cooperation between Live Nation and Sirius as we figure out how to both use assets that we have to both improve our business. But for me, that's about it. We continue to look at other areas. But I will tell you, as I've told you before, I am going to be extremely disciplined here. Just because our leverage is declining is not going to cause me to rush out and go do anything that I don't absolutely believe has a very strong return for our shareholders. And so we'll continue looking down that path and moving in that way. Dave, is there anything you want to add on point one?

David J. Frear
Senior EVP & CFO

Yes. We kind of get the need for people to sort of generate attention. And it's true in any publishing community. So it's -- for me, I wake up in the morning and I see headlines and research pieces. It's a little bit like going into the supermarket and seeing that Paul is dead or Sasquatch has sat down for candid photos or aliens abducted somebody's baby. There are lots of headlines that get put out and -- but it's not clear that they all have all that much to do with reality. But we don't comment on acquisition.

James E. Meyer
CEO & Director

Yes. So Jessica, I think to sum -- we are absolutely on the prowl. We're absolutely looking everywhere we can look. And I can tell you, we have the capacity to do almost anything we want to do. And when we find something that meets our threshold, our targeted returns, believe me, we'll jump and we know how to do that. On your second question on out-of-car, we are really focused on this. I'm not ready to answer your question exactly how that's going to show up yet. I think you've got to give us some more time to build around it. I will tell you this is one I feel really good about. And I'll tell you why. I said in about 4 earnings calls before, and someone printed that Meyer said, "Our business is technology future-proof." That's not what I meant. What I said and what I continue to believe is that competition will always be in the vehicle. It always has. It's always been strong. And competition outside the vehicle for audio will always be strong. Everyone acts like it's only recently gotten strong. Let me tell you, it's always been intense and strong, okay? But with that focus, what I am really happy about is this battle and this game, we will not be left out of it because of technology. 360L and the money we're investing in our apps and the money we're investing in our connectivity initiatives are going to allow us to do whatever we want to do. This battle going forward is going to be all about how compelling is your content, how easy to use is it and getting somebody -- sorry for the word, but hooked early on in the experience, and in our case, most important, and they're willing to pay for it. And so I couldn't be more excited about the opportunities we have. As you know, I think now that we're ready, we're also beginning to focus, and in my remarks I was very clear, on people who only want to subscribe to our service to stream on their phone or stream on a device in their home or something else independent of the car. We understand the channel conflicts that can create. And I think you're going to see over the next 6 to 12 months, we'll test our way into that to figure out a way where we hope 1 plus 1 can be more than 2. I hope that's a succinct answer. And finally, on video, I have to be honest with you, I've been surprised at -- I've been surprised at the quality of the product we put out there. And I could tell you when Howard puts his mind behind something, it's always good, especially when you marry that with our team. But I will tell you, I've been surprised at how many subscribers I've heard from that says, "Hey, I really like this and I'd like to see more." And so you should assume that I've challenged Scott's team significantly here to broaden this. And I think you'll hear more from us as we get into 2019 there.

Scott A. Greenstein
President and Chief Content Officer

Yes, just to follow up on that, I mean, one thing I want to stress again that I know Jim has said in earlier calls, right now video, we're looking to be complementary to our audio [indiscernible]. And in that area, there's plenty of content that would be appealing, whether in real time or short form, whether it's sports. And you can imagine in November with all our political channels and news channels, there may be stuff there that we can look in as we go forward with it. And eventually, the live component will be there and cut-ins and other things that I think could be really fun, but again all within sort of our content universe right now.

James E. Meyer
CEO & Director

So that's it.

Operator

And we will take our next and final question from Barton Crockett at B. Riley.

Barton Evans Crockett
B. Riley FBR, Inc., Research Division

I wanted to, I guess, ask about a couple of things. One is just to hammer home this self-pay churn rate of 1.6%. The perennial kind of concern for your company has been the growth in alternatives, the surge in Spotify, Apple Music, Amazon Music, all of which are growing like gangbusters. And yet you come up with the best loyalty that you've ever had. What impact is uptake of these services having on your consumer, on your ability to sell them new subs or retain them? How do you explain kind of this churn relative to the explosion of alternatives?

James E. Meyer
CEO & Director

So look, I think there's more music services than there's ever been. I think they continue to try to improve those services and bring them into the vehicle in an easy-to-use way. I still don't believe it's that easy to use as it's implemented in the vehicle. But we're not going to sit still and assume that, that experience won't continue to improve. I think it's actually all about the quality of the content and the quality of the experience. And I can tell you we know firsthand that if we can get customers to engage with us, we can keep them at an improved rate, then those customers that over a period of time we try to get back by enticing them with offers and things like that. Engagement is key here. And I just think that we continue to focus on getting better and better at that. I will tell you quite candidly, I still think there's a long, long way to go here, where -- we'll have customers that call us, and when we say to them, "Why did you churn," they'll say, "Oh, I was looking for this or this." And we'll say, "Did you know we have a channel that has that?" And whenever I hear that, it drives me crazy because it says we're not doing a good enough job making those people aware of what we have. With this connectivity that we're seeing now and Return Path data, we can and will do a much better job at that. And I think that bodes well. I also think though, Barton, the economy is clearly better. And then within those numbers, there's just some blocking and tackling we did a lot better. And I'm proud of our team, our team did a great job. But I'm not ready to declare victory yet. And those competitors are still there. And we'll just keep competing with them.

Barton Evans Crockett
B. Riley FBR, Inc., Research Division

But are your subscribers overindexing for using these other services and yet they're still disloyal?

James E. Meyer
CEO & Director

No, our subscribers, I can tell you, our subscribers use everything, okay? We find that they use a lot of different things. But I can also tell you that our subscribers spend an inordinate amount of time listening to our service when they're in the vehicle.

David J. Frear
Senior EVP & CFO

Barton, there's a big part of this, the services in many ways are sort of complementary. There's the times when you want to listen to your own playlist. And then there's the times when you don't that -- we are not just a music service. We have a lot of other content. And that's sort of -- you read a lot about the sort of lean-back experiences or lean-in experiences. And the fact is, is that personal music collections, which is really what the streaming services for the most part are about, have coexisted along radio for multiple decades. And both businesses have done just fine. You've seen streaming get to absolutely massive listening levels in the U.S. It's over 170 million people now. And the fact is, is that the competitive landscape and the interplay between them, it's pretty much laid out in the marketplace now. And everybody is performing the way they're performing. Jim's comments are 100% on. We've been driving this business hard for a long time and we'll continue to drive it hard. And while these services in many respects are complementary, we also compete, so we'll just go out there and slug it out every day with everybody else. And hopefully, we'll continue to deliver the great results in the future that we've been delivering for you for a long time.

James E. Meyer
CEO & Director

And so Barton, final point. I've been here almost 14 years. And during those 14 years, I've seen a couple of moments where people have said, "Oh, competition and what it's going to do." And yet you look at the unbelievable things that have occurred over the last 10 years, the unbelievable surge in technology. And yet you still look at the number of people that listen to AM/FM radio every day, okay? And honestly, that's the area, I think, that's got a problem. If they don't vastly improve their product, that's the area where I think listener hours are finally going to come -- are finally going to shift away from to other things, if you really want to know where I think it inevitably shakes out.

Hooper Stevens
Vice President of IR & Finance
Thank you, Barton. Thank you, everybody, for participating in today's call. And we'll speak to you offline and next quarter. Operator, thank you.