

SALEM COMMUNICATIONS CORP /DE/

Form 10-Q

November 09, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012**

**OR**

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

**FOR THE TRANSITION PERIOD FROM            TO**

**COMMISSION FILE NUMBER 000-26497**

**SALEM COMMUNICATIONS CORPORATION**

**(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

<p><b>DELAWARE</b> (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)</p> <p><b>4880 SANTA ROSA ROAD</b></p> <p><b>CAMARILLO, CALIFORNIA</b> (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)</p> <p><b>REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (805) 987-0400</b></p>	<p><b>77-0121400</b> (I.R.S. EMPLOYER IDENTIFICATION NUMBER)</p> <p><b>93012</b> (ZIP CODE)</p>
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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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input checked="" type="checkbox"/>

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

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

Class A Common Stock, \$0.01 par value per share	Outstanding at November 1, 2012 18,851,235 shares
Class B Common Stock, \$0.01 par value per share	Outstanding at November 1, 2012 5,553,696 shares

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**SALEM COMMUNICATIONS CORPORATION**

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**FORWARD-LOOKING STATEMENTS**

From time to time, in both written reports (such as this report) and oral statements, Salem Communications Corporation (Salem or the company, including references to Salem by we, us and our ) makes forward-looking statements within the meaning of federal and state securities laws. Disclosures that use words such as the company believes, anticipates, estimates, expects, intends, will, may or plans and similar expressions are intended to identify forward-looking statements, as defined under the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the company's current expectations and are based upon data available to the company at the time the statements are made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from expectations. These risks, as well as other risks and uncertainties, are detailed in Salem's reports on Forms 10-K, 10-Q and 8-K filed with or furnished to the Securities and Exchange Commission. Forward-looking statements made in this report speak as of the date hereof. Except as required by law, the company undertakes no obligation to update or revise any forward-looking statements made in this report. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in context with the various disclosures made by Salem about its business. These projections or forward-looking statements fall under the safe harbors of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ).

**Table of Contents****PART I FINANCIAL INFORMATION****SALEM COMMUNICATIONS CORPORATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
SALEM COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS***(Dollars in thousands, except share and per share data)*

	December 31, 2011 (Note 1)	September 30, 2012 (Unaudited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 67	\$ 195
Restricted cash	110	
Trade accounts receivable (less allowance for doubtful accounts of \$9,300 in 2011 and \$9,020 in 2012)	31,001	33,168
Other receivables	888	376
Prepaid expenses	3,395	3,904
Deferred income taxes	6,403	7,027
Assets held for sale		2,900
Assets of discontinued operations	102	8
<b>Total current assets</b>	<b>41,966</b>	<b>47,578</b>
Notes receivable (less allowance for doubtful accounts of \$100 in 2011 and \$615 in 2012) less current portion	1,459	1,458
Property, plant and equipment (net of accumulated depreciation of \$125,708 in 2011 and \$133,631 in 2012)	111,222	100,668
Broadcast licenses	371,420	373,720
Goodwill	20,092	21,330
Other indefinite-lived intangible assets	1,961	1,961
Amortizable intangible assets (net of accumulated amortization of \$22,817 in 2011 and \$24,442 in 2012)	6,469	6,484
Deferred financing costs	5,489	4,379
Other assets	1,232	1,506
<b>Total assets</b>	<b>\$ 561,310</b>	<b>\$ 559,084</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 4,565	\$ 2,684
Accrued expenses	5,542	5,587
Accrued compensation and related expenses	8,431	6,785
Accrued interest	1,127	6,389
Deferred revenue	7,521	8,153
Income tax payable	205	168
Subordinated debt due to related parties	9,000	15,000
Current portion of long-term debt and capital lease obligations	124	5,115

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Total current liabilities	36,515	<b>49,881</b>
Long-term debt and capital lease obligations, less current portion	265,679	<b>250,455</b>
Deferred income taxes	48,077	<b>46,660</b>
Deferred revenue	7,962	<b>8,087</b>
Other liabilities	29	<b>29</b>
Total liabilities	358,262	<b>355,112</b>
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Class A common stock, \$0.01 par value; authorized 80,000,000 shares; 21,051,305 and 21,151,910 issued and 18,733,655 and 18,842,260 outstanding at December 31, 2011 and September 30, 2012, respectively	210	<b>211</b>
Class B common stock, \$0.01 par value; authorized 20,000,000 shares; 5,553,696 issued and outstanding at December 31, 2011 and September 30, 2012	56	<b>56</b>
Additional paid-in capital	231,972	<b>233,034</b>
Retained earnings	4,816	<b>4,677</b>
Treasury stock, at cost (2,317,650 shares at December 31, 2011 and September 30, 2012)	(34,006)	<b>(34,006)</b>
Total stockholders' equity	203,048	<b>203,972</b>
Total liabilities and stockholders' equity	\$ 561,310	<b>\$ 559,084</b>

See accompanying notes

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## SALEM COMMUNICATIONS CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

*(Dollars in thousands, except share and per share data)*

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
Net broadcast revenue	\$ 44,793	\$ 45,895	\$ 132,929	\$ 136,224
Net Internet revenue	6,686	7,800	19,168	23,269
Net publishing revenue	3,024	3,024	9,009	9,136
<b>Total revenue</b>	<b>54,503</b>	<b>56,719</b>	<b>161,106</b>	<b>168,629</b>
<b>Operating expenses:</b>				
Broadcast operating expenses exclusive of depreciation and amortization shown below (including \$324 and \$334 for the three months ended September 30, 2011 and 2012, respectively, and \$972 and \$993 for the nine months ended September 30, 2011 and 2012, respectively, paid to related parties)	29,198	30,628	86,054	90,289
Internet operating expenses exclusive of depreciation and amortization shown below	5,080	5,825	15,457	17,858
Publishing operating expenses exclusive of depreciation and amortization shown below	2,890	2,980	8,541	8,951
Corporate expenses exclusive of depreciation and amortization shown below (including \$53 and \$35 for the three months ended September 30, 2011 and 2012, and \$379 and \$235 for the nine months ended September 30, 2011 and 2012, respectively, paid to related parties)	4,285	4,643	13,040	14,314
Depreciation	3,099	3,083	9,398	9,150
Amortization	633	494	1,835	1,625
Impairment of long-lived assets				5,608
(Gain) loss on disposal of assets	32	587	(4,343)	563
<b>Total operating expenses</b>	<b>45,217</b>	<b>48,240</b>	<b>129,982</b>	<b>148,358</b>
<b>Operating income from continuing operations</b>	<b>9,286</b>	<b>8,479</b>	<b>31,124</b>	<b>20,271</b>
<b>Other income (expense):</b>				
Interest income	57	24	154	83
Interest expense (including \$124 and \$238 respectively, for the three and nine months ended September 30, 2012 on related party debt).	(6,826)	(6,127)	(21,125)	(18,787)
Loss on early redemption of long-term debt	(305)		(1,395)	(893)
Other income (expense), net	3	60	(20)	71
<b>Income (loss) from continuing operations before income taxes</b>	<b>2,215</b>	<b>2,436</b>	<b>8,738</b>	<b>745</b>
Provision for (benefit from) income taxes	526	(971)	3,405	(1,768)
<b>Income from continuing operations</b>	<b>1,689</b>	<b>3,407</b>	<b>5,333</b>	<b>2,513</b>
Loss from discontinued operations	(204)	(39)	(161)	(94)

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Net income	\$ 1,485	\$ 3,368	\$ 5,172	\$ 2,419
Basic earnings per share data:				
Earnings per share from continuing operations	\$ 0.07	\$ 0.14	\$ 0.22	\$ 0.10
Earnings (loss) per share from discontinued operations	(0.01)		(0.01)	
Basic earnings per share	\$ 0.06	\$ 0.13	\$ 0.21	\$ 0.10
Diluted earnings per share data:				
Earnings per share from continuing operations	\$ 0.07	\$ 0.14	\$ 0.22	\$ 0.10
Earnings (loss) per share from discontinued operations	(0.01)		(0.01)	
Diluted earnings per share	\$ 0.06	\$ 0.13	\$ 0.21	\$ 0.10
Dividends per share	\$	\$ 0.13	\$	\$ 0.10
Basic weighted average shares outstanding	24,546,056	24,663,027	24,448,722	24,528,091
Diluted weighted average shares outstanding	24,746,164	25,358,052	24,665,649	24,893,832

See accompanying notes



**Table of Contents****SALEM COMMUNICATIONS CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(Dollars in thousands)*

(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	2011	2012
<b>OPERATING ACTIVITIES</b>		
Net income from continuing operations	\$ 5,333	\$ 2,513
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Non-cash stock-based compensation	646	995
Excess tax benefit from stock options exercised	(29)	
Depreciation and amortization	11,233	10,775
Amortization of deferred financing costs	1,253	970
Amortization and accretion of financing items	140	134
Provision for bad debts	2,099	1,860
Deferred income taxes	3,316	(2,041)
Impairment of long-lived assets		5,608
(Gain) loss on disposal of assets	(4,343)	563
Loss on early redemption of long-term debt	1,395	893
Changes in operating assets and liabilities:		
Accounts receivable	(1,392)	(1,579)
Prepaid expenses and other current assets	(1,311)	(509)
Accounts payable and accrued expenses	5,473	3,968
Deferred revenue	(182)	(1,752)
Other liabilities	2,799	
Income taxes payable	(203)	(37)
<b>Net cash provided by operating activities</b>	<b>26,227</b>	<b>22,361</b>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(5,931)	(6,407)
Deposits on radio station acquisitions and equipment	248	(250)
Release of restricted cash	100	110
Purchases radio stations and broadcast assets	(550)	(3,330)
Purchases of Internet businesses and assets	(6,000)	(3,165)
Proceeds from the disposal of assets	12,744	768
Other	(587)	(110)
<b>Net cash provided by (used in) investing activities</b>	<b>24</b>	<b>(12,384)</b>
<b>FINANCING ACTIVITIES</b>		
Payments of costs related to bank credit facilities	(52)	(148)
Payments of bond issue costs	(43)	
Payment of bond premium in connection with early redemption	(669)	(525)
Payments to redeem 9 <sup>5</sup> / <sub>8</sub> % Notes	(22,500)	(17,500)
Proceeds from borrowings under bank credit facility and subordinated debt	52,700	108,932
Payments on bank credit facility	(57,200)	(101,813)
Proceeds from lines of credits due to related parties		18,000
Payments under lines of credits due to related parties		(12,000)

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Proceeds from exercise of stock options	19	<b>68</b>
Excess tax benefit from stock options exercised	29	
Payments on capital lease obligations	(86)	<b>(93)</b>
Payment of cash dividend on common stock		<b>(2,558)</b>
Book overdraft	1,090	<b>(2,212)</b>
<b>Net cash used in financing activities</b>	<b>(26,712)</b>	<b>(9,849)</b>

**CASH FLOWS FROM DISCONTINUED OPERATIONS**

Operating cash flows	(242)	
Investing cash flows	(106)	
<b>Net cash inflows (outflows) from discontinued operations</b>	<b>(348)</b>	

Net increase in cash and cash equivalents (809) **128**

Cash and cash equivalents at beginning of year 828 **67**

Cash and cash equivalents at end of period \$ 19 \$ **195**

**Supplemental disclosures of cash flow information:**

Cash paid during the period for:

Interest (including \$150 paid to related parties during the nine months ending September 30, 2012) \$ 13,937 \$ **12,417**  
 Income taxes \$ 250 \$ **251**

**Non-cash investing and financing activities:**

Trade Revenue \$ 4,089 \$ **4,006**  
 Trade Expense \$ 3,443 \$ **4,012**  
 Note receivable acquired in exchange for radio station \$ 1,000 \$  
 Assets acquired under capital leases \$ 8 \$ **27**

See accompanying notes

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**SALEM COMMUNICATIONS CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1. BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements of Salem Communications Corporation ( Salem, we or the company ) include the company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Information with respect to the three and nine months ended September 30, 2011 and 2012 is unaudited. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the unaudited interim financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the financial position, results of operations and cash flows of the company. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended December 31, 2011.

The balance sheet at December 31, 2011 included in this report has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP.

**Description of Business**

Salem is a domestic multi-media company with integrated business operations covering radio broadcasting, publishing and the Internet. Our programming is intended for audiences interested in Christian and conservative opinion content and complementary programming. Our primary business is the ownership and operation of radio stations in large metropolitan markets. Upon the close of all announced transactions, we will own and/or operate 99 radio stations across the United States. We also own and operate Salem Radio Network® ( SRN ), SRN News Network ( SNN ), Salem Music Network ( SMN ), Solid Gospel Network ( SGN ), Salem Media Representatives ( SMR ) and Vista Media Representatives ( VMR ). SRN, SNN, SMN and SGN are radio networks that produce and distribute programming, such as talk, news and music segments to radio stations throughout the United States, including Salem owned and operated stations. SMR and VMR sell commercial airtime to national advertisers on radio stations and networks that we own, as well as on independent radio station affiliates.

We also operate Salem Web Network ( SWN ), our Internet businesses which provide Christian and conservative-themed content, audio and video streaming, and other resources on the web. SWN 's Internet portals include OnePlace.com, Christianity.com, Crosswalk.com, BibleStudyTools.com, GodTube.com, Townhall.com®, HotAir.com, WorshipHouseMedia.com and Jesus.org. SWN 's content is accessible through our radio station websites that feature content of interest to local listeners throughout the United States. SWN operates these Salem radio station websites as well as Salem Consumer Products, a website offering books, DVD 's and editorial content developed by many of our on-air personalities that are available for purchase. The revenues generated from this segment are reported as Internet revenue on our Condensed Consolidated Statements of Operations.

We also operate Salem Publishing , which produces and distributes Christian and conservative opinion print magazines. Salem Publishing includes Xulon Press , a print-on-demand self-publishing service for Christian authors. The revenues generated from this segment are reported as publishing revenue on our Condensed Consolidated Statements of Operations.

**Variable Interest Entities**

We account for entities qualifying as variable interest entities ( VIEs ) in accordance with Financial Accounting Standards Board Accounting Standards Codification ( FASB ASC ) Topic 810, *Consolidation* which requires VIEs to be consolidated by the primary beneficiary. The primary beneficiary is the entity that holds the majority of the beneficial interests in the VIE. A VIE is an entity for which the primary beneficiary 's interest in the entity can change with changes in factors other than the amount of investment in the entity.

We may enter into Local Marketing Agreements ( LMA 's ) contemporaneously with entering an Asset Purchase Agreement ( APA ) to acquire or sell a radio station. We may also enter into Time Brokerage Agreements ( TBA 's ). Typically, both LMA 's and TBA 's are contractual agreements under which the station owner / licensee makes air-time available to a programmer / licensee in exchange for a fee and reimbursement of certain

expenses. LMA s and TBA s are subject to compliance with the antitrust laws and the Communications Laws, including the requirement that the licensee must maintain independent control over the station and, in particular, its personnel, programming, and finances. The FCC has held that such agreements do not violate the Communications Laws as long as the licensee of the station receiving programming from another station maintains ultimate responsibility for, and control over, station operations and otherwise ensures compliance with the Communications Laws.

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The requirements of FASB ASC Topic 810 may apply to entities under LMA s or TBA s, depending on the facts and circumstances related to each transaction. We did not consolidate any entities with which we entered into LMA s or TBA s under the guidance in FASB ASC Topic 810 as of September 30, 2012.

### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas for which management uses estimates include, but are not limited to: (1) asset impairments, including broadcasting licenses, goodwill and other indefinite-lived intangible assets; (2) income tax valuation allowances; (3) uncertain tax positions; (4) allowance for doubtful accounts; (5) self-insurance reserves; (6) fair value of equity awards; (7) estimated lives for tangible and intangible assets; (8) fair value measurements; and (9) contingency reserves. These estimates require the use of judgment as future events and the effect of these events cannot be predicted with certainty. The estimates will change as new events occur, as more experience is acquired and as more information is obtained. We evaluate and update our assumptions and estimates on an ongoing basis and we may consult outside experts to assist as considered necessary.

### **NOTE 2. RECLASSIFICATIONS**

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications include the accounting for discontinued operations as described in more detail in Note 5 to our condensed consolidated financial statements.

### **NOTE 3. IMPAIRMENT OF GOODWILL AND OTHER INDEFINITE-LIVED INTANGIBLE ASSETS**

We account for goodwill and other indefinite-lived intangible assets in accordance with the FASB ASC Topic 350 Intangibles Goodwill and Other. We do not amortize goodwill or other indefinite-lived intangible assets, but rather test for impairment annually or more frequently if events or circumstances indicate that an asset may be impaired. We complete our annual impairment tests in the fourth quarter of each year unless events or circumstances indicate that an asset may be impaired.

Due to actual operating results that did not meet or exceed our expectations and assumptions used in prior valuations, we performed an interim valuation of mastheads as of June 30, 2012. Based on our review and analysis, we determined that no impairment charges were necessary for mastheads as of the interim testing period ending June 30, 2012. The estimated fair value exceeded the carrying value by approximately 1.7% as of the June 30, 2012 interim test. There were no further indications of impairment as of the period ending September 30, 2012. There were no indications of impairment during the period ending September 30, 2012, for our broadcast licenses or Internet entities. Broadcast licenses account for approximately 94% of our indefinite-lived intangible assets. Goodwill and magazine mastheads account for the remaining 6%.

### **NOTE 4. IMPAIRMENT OF LONG-LIVED ASSETS**

We account for property, plant and equipment in accordance with FASB ASC Topic 360-10, Property, Plant and Equipment. We periodically review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable.

In June 2012, based on changes in managements intended use of land in Covina, CA, we reclassified the land from our broadcast segment to assets held for sale and evaluated the land for impairment as of that date. In accordance with the authoritative guidance for impairment of long-lived assets held for sale, we determined the carrying value of the land exceeded the estimated fair value less cost to sell. We estimated the fair value of the land based on our estimated future cash flows expected from the sale of the land to a willing party less our estimated closing costs. As a result of our analysis, we recorded an impairment charge of \$5.6 million associated with the land.

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The table below presents the fair value measurements used to value this asset.

Description	As of September 30, 2012	Fair Value Measurements Using: (Dollars in thousands)			Total Gains (Losses)
		Quoted prices in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Long-Lived Asset Held for Sale	\$ 2,900			\$ 2,900	\$ 5,608

**NOTE 5. SIGNIFICANT TRANSACTIONS**

On August 31, 2012, we completed the acquisition of radio station WLCC-AM, Tampa, Florida, for \$1.2 million. We began operating the station as of the closing date.

On August 30, 2012, we acquired SermonSpice.com for \$3.0 million. SermonSpice.com is an online provider of church media for local churches and ministries. The acquisition resulted in goodwill of \$1.2 million representing the excess value of the business as a result of the organizational systems and procedures already in place to ensure the effective operation of the business.

On June 1, 2012, we redeemed \$17.5 million of our 9<sup>5</sup>/<sub>8</sub>% senior secured second lien notes ( 9<sup>5</sup>/<sub>8</sub>% Notes ) for \$18.0 million, or at a price equal to 103% of the face value. This transaction resulted in a \$0.9 million pre-tax loss on the early retirement of debt, including approximately \$80,000 of unamortized discount and \$0.3 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

On May 29, 2012, we acquired an FM translator and related construction permits for \$0.3 million that will be used in our Detroit broadcast market.

On May 15, 2012, we purchased Churchangel.com and rchurch.com for \$0.2 million. These Internet sites are operated under SWN to enhance and build our relationships with local churches and pastors.

On April 10, 2012, we completed the acquisition of radio station WKDL-AM in Warrenton, Virginia for \$30,000. We began operating the station as of the closing date.

On March 16, 2012, we completed the sale of radio station WBZS-AM in Pawtucket, Rhode Island for \$0.8 million in cash. The sale resulted in a pre-tax gain of \$0.2 million. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity through the date of the sale.

On March 7, 2012, our Board of Directors authorized and declared a quarterly dividend in the amount of \$0.035 per share on Class A and Class B common stock. Quarterly common stock dividends of \$0.9 million, or \$0.035 per share, were paid on March 31, 2012, June 29, 2012 and September 28, 2012, respectively, to all common stockholders of record. We anticipate paying quarterly common stock dividends in March, June, September and December of each year. Based on the number of shares currently outstanding, we expect to pay total annual common stock dividends of approximately \$3.4 million.

On January 13, 2012, we completed the acquisition of radio station KTNO-AM, Dallas, Texas for \$2.2 million. We began programming the station pursuant to a TBA with the current owner on November 1, 2011. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity as of the TBA date. The accompanying Condensed Consolidated Balance Sheets reflect the net assets of this entity as of the closing date.

A summary of our business acquisitions and asset purchases for the nine months ended September 30, 2012, none of which were material to our condensed consolidated financial position as of the respective date of acquisition, is as follows:

Acquisition Date	Description	Total Cost (Dollars in thousands)
August 31, 2012	WLCC-AM, Tampa, Florida	\$ 1,150

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August 30, 2012	Sermonspice.com	3,000
May 15, 2012	Churchangel.com and rchurch.com	165
April 10, 2012	WKDL-AM, Warrenton, Virginia	30
January 13, 2012	KTNO-AM, Dallas, Texas	2,150
		\$ 6,495

Under the acquisition method of accounting as specified in FASB ASC Topic 805, the total acquisition consideration is allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the date of the transaction. We obtained an

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independent third-party appraisal from Bond & Pecaro to estimate the fair value of the acquired net assets as of the acquisition date for the significant transactions noted. Property, plant and equipment are recorded at the estimated fair value and depreciated on a straight-line basis over their estimated useful lives. Intangible assets are also recorded at their estimated fair value and amortized using the straight-line method over their estimated useful lives. The total acquisition consideration was allocated to the net assets acquired as follows:

	<b>Broadcast Assets Acquired</b>	<b>Internet Assets Acquired</b>	<b>Net Assets Acquired</b>
	<i>(Dollars in thousands)</i>		
<b>Asset</b>			
Property and equipment	\$ 2,235	\$ 89	\$ 2,324
Broadcast licenses	1,086		1,086
Goodwill	9	1,231	1,240
Customer lists and contracts		157	157
Software		309	309
Customer relationships		927	927
Domain and brand names		479	479
<b>Liabilities</b>			
Subscriber liabilities assumed		(27)	(27)
	<b>\$ 3,330</b>	<b>\$ 3,165</b>	<b>\$ 6,495</b>

**Discontinued Operations:**

Based on operating results that did not meet our expectations, we ceased operating Samaritan Fundraising in December 2011. As of December 31, 2011, all employees of this entity were terminated. As a result of our decision to close operations, there will be no material cash flows associated with this entity and we have no ongoing or further involvement in the operations of this entity. The Condensed Consolidated Balance Sheets and Statements of Operations for all prior periods presented were reclassified to reflect the operating results and net assets of this entity as a discontinued operation. As of September 30, 2012, assets of discontinued operations consist of net receivables due to us from sales occurring prior to ceasing operations. The following table sets forth the components of income (loss) from discontinued operations:

	<b>Three Months Ended September 30, 2011</b>		<b>Nine Months Ended September 30, 2012</b>	
	<b>2011</b>	<b>2012</b>	<b>2011</b>	<b>2012</b>
	<i>(Dollars in thousands)</i>			
Net revenues	\$ 393	\$ 11	\$ 1,705	\$ 22
Operating expenses	(694)	(76)	(1,938)	(178)
Operating income (loss)	\$ (301)	\$ (65)	\$ (233)	\$ (156)
Provision for (benefit from) income taxes	(97)	(26)	(72)	(62)
Income (loss) from discontinued operations, net of tax	\$ (204)	\$ (39)	\$ (161)	\$ (94)

**Pending Transactions:**

On August 30, 2012, we entered into an agreement to acquire radio station WMUU-FM, Greenville, South Carolina for \$6.0 million. The \$6.0 million purchase price will consist of \$1.0 million due upon close of the transaction, \$2.0 million payable in April 2014, and \$3.0 million payable in advertising credits to Bob Jones University, a related party of the station owner. The purchase is subject to the approval by the FCC and is expected to close in the first quarter of 2013.

**NOTE 6. STOCK OPTION PLAN**



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The company has one stock option plan. The Amended and Restated 1999 Stock Incentive Plan (the Plan ) allows the company to grant stock options to employees, directors, officers and advisors of the company. At the annual meeting of the company held on June 22, 2012, the company stockholders approved a revision to the Plan to increase the number of shares authorized by 1,900,000. As a result, a maximum of 5,000,000 shares are now authorized under the Plan. Options generally vest over a four year period and have a maximum term of five years from the vesting date. The Plan provides that vesting may be accelerated in certain corporate transactions of the company. The Plan provides that the Board of Directors, or a committee appointed by the Board, has discretion, subject to certain limits, to modify the terms of outstanding options. We recognize non-cash stock-based compensation expense related to the estimated fair value of stock options granted in accordance with FASB ASC Topic 718 Compensation Stock Compensation.

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The following table reflects the components of stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	<i>(Dollars in thousands)</i>			
Stock option compensation expense included in corporate expenses	\$ 97	\$ 195	\$ 395	\$ 652
Restricted stock compensation expense included in corporate expenses			4	
Stock option compensation expense included in broadcast operating expenses	51	71	195	241
Stock option compensation expense included in Internet operating expenses	15	28	47	87
Stock option compensation expense included in publishing operating expenses	2	5	5	15
Total stock-based compensation expense, pre-tax	\$ 165	\$ 299	\$ 646	\$ 995
Tax provision for stock-based compensation expense	(37)	(119)	(247)	(430)
Total stock-based compensation expense, net of tax	\$ 128	\$ 180	\$ 399	\$ 565

**Stock Options and Restricted Stock Grants**

The Plan allows the company to grant stock options and shares of restricted stock to employees, directors, officers and advisors of the company. The option exercise price is set at the closing price of the company's common stock on the date of grant, and the related number of shares granted is fixed at that point in time. The Plan also provides for grants of restricted stock. Eligible employees may receive stock options annually with the number of shares and type of instrument generally determined by the employee's salary grade and performance level. In addition, certain management and professional level employees typically receive a stock option grant upon commencement of employment. Non-employee directors of the company have been awarded restricted stock grants that vest one year from the date of issuance as well as stock options that vest immediately. The Plan does not allow key employees and directors (restricted persons) to exercise options during pre-defined blackout periods. Employees may participate in 10b5-1 plans that allow them to exercise options according to predefined criteria.

We use the Black-Scholes option valuation model to estimate the fair value of stock options as of the grant date. The expected volatility considers the historical volatility of our stock as determined by the closing price over a six to ten year term that is generally commensurate with the expected term of the option. Expected dividends reflect the quarterly dividends authorized and declared on March 8, 2012, May 31, 2012 and August 30, 2012 of \$0.035 per share on Class A and Class B common stock. The expected term of the options are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rates for periods within the expected term of the option are based on the U.S. Treasury yield curve in effect during the period the options were granted. We use historical data to estimate future forfeiture rates to apply against the gross amount of compensation expense determined using the option valuation model.

The weighted-average assumptions used to estimate the fair value of the stock options using the Black-Scholes option valuation model were as follows for the three and nine months ended September 30, 2011 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012 <sup>1</sup>	2011	2012
Expected volatility	101.5%	n/a	101.5%	102.4%
Expected dividends	%	n/a	%	5.07%
Expected term (in years)	7.5	n/a	7.5	8.2
Risk-free interest rate	1.59%	n/a	1.64%	1.66%

Stock option information with respect to the company's stock-based compensation plans during the nine months ended September 30, 2012 is as follows (dollars in thousands, except weighted average exercise price and weighted average grant date fair value):

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Options	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2012	<b>1,640,392</b>	<b>\$ 5.01</b>	<b>\$ 4.07</b>	<b>5.2 years</b>	<b>\$ 2,935</b>
Granted	<b>626,000</b>	<b>2.74</b>	<b>1.51</b>		<b>1,566</b>
Exercised	<b>(108,605)</b>	<b>0.62</b>	<b>0.44</b>		<b>458</b>
Forfeited or expired	<b>(68,263)</b>	<b>14.00</b>	<b>7.91</b>		<b>9</b>
Outstanding at September 30, 2012	<b>2,089,524</b>	<b>4.26</b>	<b>3.36</b>	<b>5.7 years</b>	<b>3,991</b>
Exercisable at September 30, 2012	<b>770,949</b>	<b>6.34</b>	<b>4.86</b>	<b>3.2 years</b>	<b>1,090</b>
Expected to Vest	<b>1,251,987</b>	<b>3.05</b>	<b>2.49</b>	<b>7.1 years</b>	<b>2,754</b>

<sup>1</sup> No stock options were granted during this period.

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The aggregate intrinsic value represents the difference between the company's closing stock price on September 28, 2012 of \$5.24 and the option exercise price of the shares for stock options that were in the money, multiplied by the number of shares underlying such options. The total fair value of options vested during the nine months ended September 30, 2011 and 2012 was \$0.8 million and \$0.7 million, respectively. There were no restricted stock grants outstanding as of the three or nine months ended September 30, 2011 and 2012, respectively.

As of September 30, 2012, there was \$1.6 million of total unrecognized compensation cost related to non-vested awards of stock options and restricted shares. This cost is expected to be recognized over a weighted-average period of 2.2 years.

### **NOTE 7. RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2012, the FASB issued Accounting Standards Update (ASU) 2012-02, Intangibles—Goodwill and Other—Testing Indefinite-lived Intangible Assets for Impairment. The updated guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not, defined as a likelihood of more than 50%, that an indefinite-lived intangible asset is impaired. If it is determined that it is more likely than not that an impairment exists, then the company is required to estimate the fair value of the indefinite-lived intangible assets and perform the quantitative impairment test in accordance with ASU 350-30. This ASU is effective for fiscal years, and interim periods within those years, beginning after September 15, 2012. Early adoption is permitted as of a date before July 27, 2012. The adoption of ASU 2012-02 is not expected to have a material impact on our financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities (ASU No. 2011-11). This ASU requires us to disclose both net and gross information about assets and liabilities that have been offset, if any, and the related arrangements. The disclosures under this new guidance are required to be provided retrospectively for all comparative periods presented. We are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of ASU No. 2011-11 is not expected to have a material impact on our financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08, Testing Goodwill for Impairment (ASU No. 2011-08), which is intended to simplify goodwill impairment testing. Entities will be allowed to perform a qualitative assessment on goodwill impairment to determine whether a quantitative assessment is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of ASU No. 2011-08 is not expected to have a material impact on our financial position, results of operations or cash flows.

### **NOTE 8. EQUITY TRANSACTIONS**

We account for stock-based compensation expense in accordance with FASB ASC Topic 718 Compensation—Stock Expense. As a result, \$0.3 million and \$1.0 million of non-cash stock-based compensation expense has been recorded to additional paid-in capital for the three and nine months ended September 30, 2012, respectively, in comparison to \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2011.

On March 7, 2012, our Board of Directors authorized and declared a quarterly dividend in the amount of \$0.035 per share on Class A and Class B common stock. Quarterly common stock dividends of \$0.9 million, or \$0.035 per share, were paid on March 31, 2012, June 29, 2012 and September 28, 2012, to all common stockholders of record. We anticipate paying quarterly common stock dividends in March, June, September and December of each year. Based on the number of shares currently outstanding, we expect to pay total annual common stock dividends of approximately \$3.4 million.

### **NOTE 9. NOTES PAYABLE AND LONG-TERM DEBT**

#### **Senior Credit Facility**

On December 1, 2009, our parent company, Salem Communications Corporation, entered into a revolver (the Revolver). We amended the Revolver on November 1, 2010 to increase the borrowing capacity from \$30 million to \$40 million. The amendment allows us to use borrowings under the Revolver, subject to the Available Amount as defined by the terms of the Credit Agreement, to redeem applicable portions of the 9.8% Notes. The calculation of the Available Amount also pertains to the payment of dividends when the leverage ratio is above 5.0 to 1.

On November 15, 2011, we completed the Second Amendment of our Revolver to among other things, (1) extend the maturity date from December 1, 2012 to December 1, 2014, (2) change the interest rate applicable to LIBOR or the Wells Fargo base rate plus a spread to be determined based on our leverage ratio, (3) allow us to borrow and repay unsecured indebtedness provided certain



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conditions are met and (4) include step-downs related to our leverage ratio covenant. We incurred \$0.5 million in fees to complete this amendment, which are being amortized over the remaining term of the agreement. The applicable interest rate relating to the amended credit agreement is LIBOR plus a spread of 3.0% per annum or the Base Rate plus a spread of 1.25% per annum, which is adjusted based on our leverage ratio. If an event of default occurs, the interest rate may increase by 2.0% per annum. Details of the change in our rate based on our leverage ratio are as follows:

Consolidated Leverage Ratio	Base Rate	Eurodollar Rate Loans	Applicable Fee Rate
Less than 3.25 to 1.00	0.75%	2.25%	0.40%
Greater than or equal to 3.25 to 1.00 but less than 4.50 to 1.00	0.75%	2.50%	0.50%
Greater than or equal to 4.50 to 1.00 but less than 6.00 to 1.00	1.25%	3.00%	0.60%
Greater than or equal to 6.00 to 1.00	2.25%	3.50%	0.75%

The Revolver includes a \$5 million subfacility for standby letters of credit and a subfacility for swingline loans of up to \$5 million, subject to the terms and conditions of the credit agreement relating to the Revolver. In addition to interest charges outlined above, we pay a commitment fee on the unused balance based on the Applicable Fee Rate in the above table. If an event of default occurs, the interest rate may increase by 2.00% per annum. Amounts outstanding under the Revolver may be paid and then reborrowed at the company's discretion without penalty or premium. At September 30, 2012 the blended interest rate on amounts outstanding under the Revolver was 3.29%. We believe that our borrowing capacity under the Revolver allows us to meet our ongoing operating requirements, fund capital expenditures, and satisfy our debt service requirements.

With respect to financial covenants, the credit agreement includes a maximum leverage ratio of 6.25 to 1.0 and a minimum interest coverage ratio of 1.5 to 1. The credit agreement also includes other negative covenants that are customary for credit facilities of this type, including covenants that, subject to exceptions described in the Credit Agreement, restrict the ability of Salem and the guarantors: (i) to incur additional indebtedness; (ii) to make investments; (iii) to make distributions, loans or transfers of assets; (iv) to enter into, create, incur, assume or suffer to exist any liens; (v) to sell assets; (vi) to enter into transactions with affiliates; (vii) to merge or consolidate with, or dispose of all or substantially all assets to, a third party; (viii) to prepay indebtedness; and (ix) to pay dividends. As of September 30, 2012, our leverage ratio was 4.97 to 1 and our interest coverage ratio was 2.18 to 1. We were in compliance with our debt covenants under the Revolver at September 30, 2012, and we remain in compliance.

Our parent company, Salem Communications Corporation, has no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several, and any subsidiaries of the parent company other than the subsidiary guarantors are minor.

**Senior Secured Second Lien Notes**

On December 1, 2009, we issued \$300.0 million principal amount of 9<sup>5</sup>/<sub>8</sub>% Notes at a discount for \$298.1 million resulting in an effective yield of 9.75%. Interest is due and payable on June 15 and December 15 of each year, commencing June 15, 2010 until maturity. We are not required to make principal payments on the 9<sup>5</sup>/<sub>8</sub>% Notes that are due in full in December 2016. The 9<sup>5</sup>/<sub>8</sub>% Notes are guaranteed by all of our existing domestic restricted subsidiaries. Upon issuance, we were required to pay \$28.9 million per year in interest on the then outstanding 9<sup>5</sup>/<sub>8</sub>% Notes. As of December 31, 2011 and September 30, 2012, accrued interest on the 9<sup>5</sup>/<sub>8</sub>% Notes was \$1.0 million and \$6.2 million, respectively. The discount is being amortized to interest expense over the term of the 9<sup>5</sup>/<sub>8</sub>% Notes based on the effective interest method. For each of the three and nine months ended September 30, 2012 and 2011, approximately \$48,000 and \$0.1 million, respectively, of the discount has been recognized as interest expense.

On June 1, 2012, we redeemed \$17.5 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$18.0 million, or at a price equal to 103% of the face value. This transaction resulted in a \$0.9 million pre-tax loss on the early retirement of debt, including approximately \$80,000 of unamortized discount and \$0.3 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

On December 12, 2011, we redeemed \$12.5 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$12.9 million, or at a price equal to 103% of the face value. This transaction resulted in a \$0.8 million pre-tax loss on the early retirement of debt, including approximately \$62,000 of unamortized discount and \$0.3 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

On September 6, 2011, we repurchased \$5.0 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$5.1 million, or at a price equal to 102<sup>7</sup>/<sub>8</sub>% of the face value. This transaction resulted in a \$0.3 million pre-tax loss on the early retirement of debt, including approximately \$26,000 of unamortized discount and \$0.1 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

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On June 1, 2011, we redeemed \$17.5 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$18.0 million, or at a price equal to 103% of the face value. This transaction resulted in a \$1.1 million pre-tax loss on the early retirement of debt, including \$0.1 million of unamortized discount and \$0.5 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

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Information regarding repurchases and redemptions of the 9<sup>5</sup>/<sub>8</sub>% Notes are as follows:

Date	Principal Redeemed/Repurchased	Premium Paid	Unamortized Discount	Bond Issue Costs
	<i>(Dollars in thousands)</i>			
June 1, 2012	\$ 17,500	\$ 525	\$ 80	\$ 287
December 12, 2011	12,500	375	62	337
September 6, 2011	5,000	144	26	135
June 1, 2011	17,500	525	93	472
December 1, 2010	12,500	375	70	334
June 1, 2010	17,500	525	105	417

The carrying value of the 9<sup>5</sup>/<sub>8</sub>% Notes was \$233.8 million and \$216.5 million at December 31, 2011 and September 30, 2012, respectively.

**Subordinated Credit Facility with First California Bank**

On May 21, 2012, we entered into a new Business Loan Agreement, Promissory Note and related loan documents with First California Bank (the FCB Loan). The FCB Loan is an unsecured, \$10.0 million fixed-term loan with a maturity date of June 15, 2014. The interest rate for the FCB Loan (Interest Rate) is variable and shall be equal to the greater of: (a) 4.250% or (b) the Wall Street Journal Prime Rate as published in The Wall Street Journal and reported by FCB plus 1%.

We are required to repay the FCB Loan as follows: (a) twenty three (23) consecutive monthly interest payments based upon the then-current principal balance outstanding at the then-current Interest Rate commencing on September 15, 2012; (b) seven quarterly consecutive principal payments of \$1.25 million each commencing on September 15, 2012; and (c) one final principal and interest payment on June 15, 2014 of all outstanding and unpaid interest and principal as of such maturity date. The FCB Loan may be prepaid at any time subject to a minimum interest charge of Fifty Dollars (\$50). If an event of default occurs on the FCB Loan, the Interest Rate may increase by 5.00% per annum. At September 30, 2012, the outstanding principal balance on the FCB loan was \$8.8 million with approximately \$26,900 of accrued interest.

The FCB Loan is unsecured and is subordinate in all respects to our existing Revolver. Our obligations under the FCB Loan are guaranteed by personal guaranties executed in favor of FCB by Edward G. Atsinger III, Salem's CEO and board member, Mr. Stuart Epperson, Salem's Chairman of the Board and board member and trusts controlled by these two individuals. With respect to financial covenants, the FCB Loan includes a maximum leverage ratio of 6.25 to 1.0 through December 31, 2012, 6.00 to 1.0 from January 1, 2013 through December 31, 2013, and 5.50 to 1.0 from January 1, 2014 through maturity; and a minimum interest coverage ratio of 1.5 to 1. The FCB Loan also includes other customary negative covenants that restrict the ability of Salem and the guarantors: (i) to incur additional indebtedness; (ii) to make investments; (iii) to make distributions, loans or transfers of assets; (iv) to enter into, create, incur, assume or suffer to exist any liens; (v) to sell assets; (vi) to enter into transactions with affiliates; (vii) to merge or consolidate with, or dispose of all or substantially all assets to, a third party; (viii) to prepay indebtedness; and (ix) to pay dividends. At September 30, 2012, our leverage ratio was 4.97 to 1 and our interest coverage ratio was 2.18 to 1. We were in compliance with our debt covenants under the FCB Loan at September 30, 2012, and we remain in compliance.

**Subordinated Lines of Credit with Related Parties**

On November 17, 2011, we entered into Affiliate Lines of Credit with Edward G. Atsinger III, Chief Executive Officer and director of Salem, and Stuart W. Epperson, Chairman of Salem's board of directors. Pursuant to the related agreements, Mr. Epperson has committed to provide an unsecured revolving line of credit to Salem in a principal amount of up to \$3 million, and Mr. Atsinger has committed to provide an unsecured revolving line of credit in a principal amount of up to \$6 million. On May 21, 2012, we entered into a line of credit with Roland S. Hinz, a Salem board member. Mr. Hinz committed to provide an unsecured revolving line of credit (LOC) in a principal amount of up to \$6.0 million. On September 12, 2012, we amended and restated the original line of credit with Mr. Hinz to increase the unsecured revolving line of credit by \$6.0 million for a total line of credit of up to \$12.0 million (together, the Affiliate Lines of Credit).

The proceeds of the Affiliate Lines of Credit may be used to repurchase a portion of Salem's outstanding 9<sup>5</sup>/<sub>8</sub>% Notes. Outstanding amounts under each Affiliate Line of Credit will bear interest at a rate equal to the lesser of (1) 5% per annum and (2) the maximum rate permitted for subordinated debt under the Revolver referred to above plus 2% per annum. Interest is payable at the time of any repayment of principal. In addition, outstanding amounts under each Affiliate Line of Credit must be repaid within three (3) months from the time that such amounts are borrowed, with the exception of the LOC with Mr. Hinz, which must be repaid within six (6) months from the time that such amounts are borrowed. The Affiliate Lines of Credit do not contain any covenants. At December 31, 2011 and September 30, 2012, \$9.0 million and \$15.0



million, respectively, was outstanding under these Affiliate Lines of Credit.

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Because the transactions with Mrs. Atsinger, Epperson and Hinz described above constitute related party transactions, the nominating and corporate governance committee (the Committee) of Salem's board of directors approved the entry by Salem into the LOC and any definitive credit agreements associated therewith. As part of its consideration, the Committee concluded that the terms of the LOC were more favorable to Salem as compared to terms of lines of credit available from unaffiliated third parties.

**Summary of long-term debt obligations**

Long-term debt consisted of the following:

	As of December 31, 2011	As of September 30, 2012
	<i>(Dollars in thousands)</i>	
Revolver under senior credit facility	\$ 31,000	\$ 29,369
9 <sup>5</sup> / <sub>8</sub> % senior secured second lien notes due 2016	233,846	216,561
Subordinated debt		8,750
Subordinated debt due to related parties	9,000	15,000
Capital leases and other loans	957	890
	274,803	270,570
Less current portion	(9,124)	(20,115)
	\$ 265,679	\$ 250,455

In addition to the amounts listed above, we also have interest payments related to our long-term debt as follows as of September 30, 2012:

Outstanding borrowings of \$29.4 million under the Revolver, with interest payments due at LIBOR plus 3.00% or at prime rate plus 1.25%;

\$217.5 million 9<sup>5</sup>/<sub>8</sub>% Notes with semi-annual interest payments at an annual rate of 9<sup>5</sup>/<sub>8</sub>%;

Outstanding borrowings of \$10.0 million on the FCB loan with interest payments due at the greater of: (a) 4.250% or (b) the Wall Street Journal Prime Rate as published in The Wall Street Journal and reported by FCB plus 1%;

Outstanding borrowings of \$15.0 million due to related parties at an interest rate equal to the lesser of (1) 5% per annum and (2) the maximum rate permitted for subordinated debt under the Revolver plus 2% per annum; and

Commitment fee of 0.60% on the unused portion of the Revolver.

**Other Debt**

We have several capital leases related to various office equipment. The obligation recorded at December 31, 2011 and September 30, 2012 represents the present value of future commitments under the lease agreements.

**Maturities of Long-Term Debt**

Principal repayment requirements under all long-term debt agreements outstanding at September 30, 2012 for each of the next five years and thereafter are as follows:

	Amount
<b>For the Twelve Months Ended September 30,</b>	<i>(Dollars in thousands)</i>
2013	\$ 20,115
2014	3,849
2015	29,459
2016	71
2017	216,635
Thereafter	441
	\$ 270,570

**Table of Contents****NOTE 10. DEFERRED FINANCING COSTS**

Deferred financing costs consist of bond issue costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes and bank loan fees associated with the Revolver and FCB Loan. The capitalized costs are being amortized over the debt term on a straight-line basis. Deferred financing costs consist of the following:

	As of December 31, 2011	As of September 30, 2012	
		<i>(Dollars in thousands)</i>	
Bond issue costs	\$ 4,219	\$	3,313
Bank loan fees	1,270		1,066
	\$ 5,489	\$	4,379

**NOTE 11. AMORTIZABLE INTANGIBLE ASSETS**

The following tables provide details, by major category, of the significant classes of amortizable intangible assets:

	As of September 30, 2012		
	Cost	Accumulated Amortization	Net
	<i>(Dollars in thousands)</i>		
Customer lists and contracts	\$ 16,604	\$ (12,267)	\$ 4,337
Domain and brand names	8,782	(6,968)	1,814
Favorable and assigned leases	1,649	(1,587)	62
Other amortizable intangible assets	3,891	(3,620)	271
	\$ 30,926	\$ (24,442)	\$ 6,484

	As of December 31, 2011		
	Cost	Accumulated Amortization	Net
	<i>(Dollars in thousands)</i>		
Customer lists and contracts	\$ 15,519	\$ (11,372)	\$ 4,147
Domain and brand names	8,227	(6,436)	1,791
Favorable and assigned leases	1,649	(1,536)	113
Other amortizable intangible assets	3,891	(3,473)	418
	\$ 29,286	\$ (22,817)	\$ 6,469

Based on the amortizable intangible assets as of September 30, 2012, we estimate amortization expense for the next five years to be as follows:

Year Ending December 31,	Amortization Expense
	<i>(Dollars in thousands)</i>
2012 (July - Dec)	\$ 557
2013	2,151
2014	1,829
2015	1,160
2016	426
Thereafter	361

Total	\$	6,484
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**NOTE 12. BASIC AND DILUTED NET EARNINGS PER SHARE**

Basic net earnings per share has been computed using the weighted average number of Class A and Class B shares of common stock outstanding during the period. Diluted net earnings per share is computed using the weighted average number of shares of Class A and Class B common stock outstanding during the period plus the dilutive effects of stock options.

Options to purchase 1,707,025 and 2,089,524 shares of Class A common stock were outstanding at September 30, 2011 and 2012, respectively. There were no outstanding restricted stock awards as of September 30, 2011 or 2012. Diluted weighted average shares outstanding exclude outstanding stock options whose exercise price is in excess of the average price of the company's stock price. These options are excluded from the respective computations of diluted net income or loss per share because their effect would be anti-dilutive. As of September 30, 2011 and 2012, there were 200,108 and 695,025 dilutive shares, respectively.

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### **NOTE 13. FAIR VALUE ACCOUNTING**

FASB ASC Topic 820 Fair Value Measurements and Disclosures established a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring fair value. This framework defined three levels of inputs to the fair value measurement process and requires that each fair value measurement be assigned to a level corresponding to the lowest level input that is significant to the fair value measurement in its entirety. The three broad levels of inputs defined by the FASB ASC Topic 820 hierarchy are as follows:

Level 1 Inputs quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date;

Level 2 Inputs inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability; and

Level 3 Inputs unobservable inputs for the asset or liability. These unobservable inputs reflect the entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability, and are developed based on the best information available in the circumstances (which might include the reporting entity's own data).

As of September 30, 2012, the carrying value of cash and cash equivalents, trade accounts receivables, accounts payable, accrued expenses and accrued interest approximates fair value due to the short-term nature of such instruments. The carrying value of other long-term liabilities approximates fair value as the related interest rates approximate rates currently available to the company.

### **NOTE 14. INCOME TAXES**

We account for income taxes in accordance with FASB ASC Topic 740 Income Taxes. We recorded an increase in our unrecognized tax benefits of \$0.3 million as of September 30, 2011 and a net decrease of \$2.1 million as of September 30, 2012. At December 31, 2011, we had \$3.9 million in liabilities for unrecognized tax benefits. Included in this liability amount were \$0.1 million accrued for the related interest, net of federal income tax benefits, and \$0.02 million for the related penalty recorded in income tax expense on our Condensed Consolidated Statements of Operations. During the three months ending September 30, 2012, we released a portion of the reserve related to state income taxes for which the statute of limitations has expired. In addition, we have re-evaluated our position related to the reasoning for establishing the reserve and determined that additions to the reserve are no longer applicable. Accordingly, as the statute of limitations expires for each tax year, an additional portion of the reserve will be released.

#### ***Valuation Allowance (Deferred Taxes)***

For financial reporting purposes, we recorded a valuation allowance of \$0.2 million as of September 30, 2012 to offset a portion of the deferred tax assets related to the state net operating loss carryforwards. Management regularly reviews our financial forecasts in an effort to determine our ability to utilize the net operating loss carryforwards for tax purposes. Accordingly, the valuation allowance is adjusted periodically based on management's estimate of the benefit the company will receive from such carryforwards.

### **NOTE 15. COMMITMENTS AND CONTINGENCIES**

The company enters into various agreements in the normal course of business that contain minimum guarantees. The typical minimum guarantee is tied to future revenue amounts that exceed the contractual level. Accordingly, the fair value of these arrangements is zero.

The company and its subsidiaries, incident to its business activities, at various times are parties to a number of legal proceedings, lawsuits, arbitration and other claims. Such matters are subject to many uncertainties and outcomes that are not predictable with assurance. The company maintains insurance that may provide coverage for such matters. Consequently, the company is unable to ascertain the ultimate aggregate amount of monetary liability or the financial impact with respect to these matters. The company believes, at this time, that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon the company's consolidated financial position, results of operations or cash flows.

**NOTE 16. SEGMENT DATA**

FASB ASC Topic 280 Segment Reporting requires companies to provide certain information about their operating segments. We operate in three segments, radio broadcasting, Internet and publishing of which our radio broadcasting and Internet segment are reportable segments. Our radio broadcasting segment operates radio stations throughout the United States, as well as various radio networks and our National sales group. Our Internet segment operates all of our websites and our consumer product sales. Our publishing segment operates our print magazine and Xulon Press, a print-on-demand book publisher.

Management uses operating income before depreciation, amortization, impairment of long-lived assets, and (gain) loss on disposal of assets as its measure of profitability for purposes of assessing performance and allocating resources.

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	Radio Broadcast	Internet	Publishing	Corporate	Consolidated
	<i>(Dollars in thousands)</i>				
<b>Three Months Ended September 30, 2012</b>					
Net revenue	\$ 45,895	\$ 7,800	\$ 3,024	\$	\$ 56,719
Operating expenses	30,628	5,825	2,980	4,643	44,076
Operating income (loss) before depreciation, amortization , impairment of long-lived assets and (gain) loss on disposal of assets	\$ 15,267	\$ 1,975	\$ 44	\$ (4,643)	\$ 12,643
Depreciation	2,059	604	109	311	3,083
Amortization	19	473	2		494
Impairment of long-lived assets (Gain) loss on disposal of assets	588			(1)	587
Operating income (loss) from continuing operations	\$ 12,601	\$ 898	\$ (67)	\$ (4,953)	\$ 8,479
<b>Three Months Ended September 30, 2011</b>					
Net revenue	\$ 44,793	\$ 6,686	\$ 3,024	\$	\$ 54,503
Operating expenses	29,198	5,080	2,890	4,285	41,453
Operating income (loss) before depreciation, amortization , impairment of long-lived assets and (gain) loss on disposal of assets	\$ 15,595	\$ 1,606	\$ 134	\$ (4,285)	\$ 13,050
Depreciation	2,182	519	87	311	3,099
Amortization	35	580	18		633
(Gain) loss on disposal of assets	53	(28)		7	32
Operating income (loss) from continuing operations	\$ 13,325	\$ 535	\$ 29	\$ (4,603)	\$ 9,286
<b>Nine months Ended September 30, 2012</b>					
Net revenue	\$ 136,224	\$ 23,269	\$ 9,136	\$	\$ 168,629
Operating expenses	90,289	17,858	8,951	14,314	131,412
Operating income (loss) before depreciation, amortization, impairment of long-lived assets and (gain) loss on disposal of assets	\$ 45,935	\$ 5,411	\$ 185	\$ (14,314)	\$ 37,217
Depreciation	6,194	1,746	305	905	9,150
Amortization	86	1,531	7	1	1,625
Impairment of long-lived assets (Gain) loss on disposal of assets	5,608	7		3	5,608
Operating income (loss) from continuing operations	\$ 33,494	\$ 2,127	\$ (127)	\$ (15,223)	\$ 20,271
<b>Nine months Ended September 30, 2011</b>					
Net revenue	\$ 132,929	\$ 19,168	\$ 9,009	\$	\$ 161,106
Operating expenses	86,054	15,457	8,541	13,040	123,092
Operating income (loss) before depreciation, amortization, impairment of long-lived assets and (gain) loss on disposal of assets	\$ 46,875	\$ 3,711	\$ 468	\$ (13,040)	\$ 38,014
Depreciation	6,670	1,569	224	935	9,398
Amortization	101	1,619	114	1	1,835
(Gain) loss on disposal of assets	(4,487)	(12)		156	(4,343)
Operating income (loss) from continuing operations	\$ 44,591	\$ 535	\$ 130	\$ (14,132)	\$ 31,124





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	<b>Radio Broadcast</b>	<b>Internet</b>	<b>Publishing</b>	<b>Corporate</b>	<b>Consolidated</b>
	<i>(Dollars in thousands)</i>				
<b>As of September 30, 2012</b>					
Property, plant and equipment, net	\$ 84,018	\$ 6,268	\$ 1,307	\$ 9,075	\$ 100,668
Broadcast licenses	373,720				373,720
Goodwill	3,881	16,104	1,337	8	21,330
Other indefinite-lived intangible assets			1,961		1,961
Amortizable intangible assets, net	125	6,343	13	3	6,484
<b>As of December 31, 2011</b>					
Property, plant and equipment, net	\$ 95,295	\$ 5,752	\$ 1,233	\$ 8,942	\$ 111,222
Broadcast licenses	371,420				371,420
Goodwill	3,873	14,874	1,337	8	20,092
Other indefinite-lived intangible assets			1,961		1,961
Amortizable intangible assets, net	211	6,235	19	4	6,469

**NOTE 17. SUBSEQUENT EVENTS**

On October 2, 2012, we acquired Godvine.com for \$4.2 million. Godvine.com is a website with family-friendly videos that expands our online presence and audience reach.

On October 19, 2012, we entered into an agreement to purchase radio station WJKR-FM in Columbus, Ohio for \$4.0 million. We began programming this station under an LMA agreement as of November 1, 2012. The purchase is subject to the approval by the FCC and is expected to close in the first quarter of 2013.

On November 6, 2012, we gave notice to redeem \$4.0 million of our 9<sup>5</sup>/<sub>8</sub>% Notes at a price equal to 103% of the face value on December 12, 2012.

Subsequent events reflect all applicable transactions through the date of the filing.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**GENERAL**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this report. Our condensed consolidated financial statements are not directly comparable from period to period due to acquisitions and dispositions of selected assets of radio stations and acquisitions of various Internet and publishing businesses. See Note 5 of our condensed consolidated financial statements for additional information.

Salem is a domestic multi-media company with integrated business operations covering radio broadcasting, publishing and the Internet. Our programming is intended for audiences interested in Christian and conservative opinion content.

**Broadcast Segment**

Broadcast revenues are impacted by the program rates our radio stations charge, the level of broadcast airtime sold and by the advertising rates our radio stations and networks charge. The rates for block programming time are based upon our stations' ability to attract audiences that will support the program producers through contributions and purchases of their products. Advertising rates are based upon the demand for advertising time, which in turn is based on our stations and networks' ability to produce results for their advertisers. We do not subscribe to traditional audience measuring services for most of our radio stations. Instead, we have marketed ourselves to advertisers based upon the responsiveness of our audiences. In selected markets, we do subscribe to Arbitron, which develops quarterly reports to measure a radio station's audience share in the demographic groups targeted by advertisers. Each of our radio stations and our networks has a pre-determined level of time that they make available for block programming and/or advertising, which may vary at different times of the day.

Arbitron has developed technology to collect data for its ratings service. The PPM is a small device that does not require active manipulation by the end user and is capable of automatically measuring radio, television, Internet, satellite radio and satellite television signals that are encoded for the service by the broadcaster. The PPM offers a number of advantages over the traditional diary ratings collection system including ease of use, more reliable ratings data and shorter time periods between when advertising runs and when audience listening or viewing habits can be reported. This service is already in a number of our markets and is scheduled to be introduced in more markets in the future. It is not clear what long-term impact, if any, the introduction of the PPM will have on our revenues for stations that subscribe to Arbitron.

As is typical in the radio broadcasting industry, our second and fourth quarter advertising revenue generally exceeds our first and third quarter advertising revenue. This seasonal fluctuation in advertising revenue corresponds with quarterly fluctuations in the retail advertising industry. Additionally, we experience increased demand for advertising during election years by way of political advertisements. Quarterly revenue from the sale of block programming time does not tend to vary significantly because program rates are generally set annually and are recognized on a per program basis. We currently program 39 of our stations with our Christian Teaching and Talk format, which is talk programming with Christian and family themes. We also program 25 News Talk stations, 11 Contemporary Christian Music stations, 10 Business format stations, and 7 Spanish-language Christian Teaching and Talk stations. The business format features financial experts, business talk, and nationally recognized Bloomberg programming. The business format operates similar to our Christian Teaching and Talk format as it features long-form block programming.

Our cash flow is historically affected by a transitional period experienced by radio stations when, due to the nature of the radio station, our plans for the market and other circumstances, we find it beneficial to change its format. This transitional period is when we develop a radio station's listener and customer base. During this period, a station may generate negative or insignificant cash flow.

In the broadcasting industry, radio stations often utilize trade or barter agreements to exchange advertising time for goods or services in lieu of cash. In order to preserve the sale of our advertising time for cash, we generally enter into trade agreements only if the goods or services bartered to us will be used in our business. We have minimized our use of trade agreements and have generally sold most of our advertising time for cash. In 2011, we sold 97% of our broadcast revenue for cash. In addition, it is our general policy not to preempt advertising paid for in cash with advertising paid for in trade.

The primary operating expenses incurred in the ownership and operation of our radio stations include: (i) employee salaries, commissions and related employee benefits and taxes, (ii) facility expenses such as rent and utilities, (iii) marketing and promotional expenses and (iv) music license fees. In addition to these expenses, our network incurs programming costs and lease expenses for satellite communication facilities. We also incur and expect to continue to incur significant depreciation, amortization and interest expense as a result of completed and future acquisitions and existing and future borrowings.



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### **Internet Segment**

Salem Web Network and our Internet business earns revenues from the sales of streaming services, sales of advertising and, to a lesser extent, sales of software, software support contracts and consumer products such as DVD s and editorial products. The revenues of these businesses are reported as Internet revenue on our Condensed Consolidated Statements of Operations.

The primary operating expense incurred in the ownership and operation of our Internet businesses include: (i) employee salaries, commissions and related employee benefits and taxes, (ii) facility expenses such as rent and utilities, (iii) marketing and promotional expenses and (iv) streaming costs.

### **Publishing Segment**

Our publishing business, Salem Publishing, earns revenues from advertising in and subscriptions to our magazine publications and from book sales. Xulon Press generally earns its revenue from fees paid by authors in association with the publishing of their books. The revenues of these businesses are reported as publishing on our Condensed Consolidated Statements of Operations.

The primary operating expenses incurred by Salem Publishing include: (i) employee salaries, commissions and related employee benefits and taxes, (ii) facility expenses such as rent and utilities, (iii) marketing and promotional expenses and (iv) printing and production costs, including paper costs.

We maintain a website at [www.salem.cc](http://www.salem.cc). Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports are available free of charge through our website as soon as reasonably practicable after those reports are electronically filed with or furnished to the Securities and Exchange Commission ( SEC ). *Any information found on our website is not a part of, or incorporated by reference into, this or any other report of the company filed with, or furnished to, the SEC.*

## **OVERVIEW**

Our radio-broadcasting segment derives revenue primarily from the sale of broadcast time and radio advertising on a national and local basis.

Our principal sources of broadcast revenue include:

the sale of block program time, both to national and local program producers;

the sale of advertising time on our radio stations, both to national and local advertisers; and

the sale of advertising time on our national radio network.

The rates we are able to charge for broadcast time and advertising time are dependent upon several factors, including:

audience share;

how well our stations perform for our clients;

the size of the market;

the general economic conditions in each market; and

supply and demand on both a local and national level.

Our principal sources of Internet revenue include:

the sale of Internet advertising;

the support and promotion to stream third-party content on our websites;

sales of software and support services; and

product sales and royalties for on-air host materials.

Our principal sources of publishing revenue include:

subscription fees for our magazines;

the sale of print magazine advertising;

fees from authors for book publishing; and

the sale of books.

**Table of Contents****RESULTS OF OPERATIONS***Three months ended September 30, 2012 compared to the three months ended September 30, 2011*

The following factors affected our results of operations and cash flows for the three months ended September 30, 2012 as compared to the same period of the prior year:

**Financing**

On September 28, 2012, we paid a quarterly common stock dividend of \$0.9 million, or \$0.035 per share.

On September 12, 2012, we amended and restated the original affiliate line of credit with Roland S. Hinz, a Salem board member, to increase the unsecured revolving line of credit by \$6.0 million for a total line of credit of up to \$12.0 million, the full amount of which was outstanding at September 30, 2012.

**Acquisitions**

On August 31, 2012, we completed the acquisition of radio station WLCC-AM, Tampa, Florida, for \$1.2 million.

On August 30, 2012, we purchased SermonSpice.com for \$3.0 million.

**Net Broadcasting Revenue**

	2011	Three Months Ended September 30,			2011 % of Total Net Revenue	2012
		2012	Change \$	Change %		
Net Broadcast Revenue	\$ 44,793	\$ 45,895	\$ 1,102	2.5%	82.2%	80.9%
Same Station Net Broadcast Revenue	\$ 44,763	\$ 45,721	\$ 958	2.1%		

Net broadcast revenues increased over the same period of the prior year due to a \$1.1 million increase in political advertisements as well as a \$0.3 million increase in block programming revenue primarily on our Christian Teaching and Talk format stations partially offset by a reduction in the number of infomercials. Increases in block programming revenues reflect annual rate increases and additional time sold. Increases in advertising revenues reflect higher volume due to advertisers purchasing more air-time or participation in listener purchasing programs.

The following table shows the dollar amount and percentage of net broadcast revenue for each broadcast revenue source:

	Three Months Ended September 30,			
	2011		2012	
	(Dollars in thousands)			
Block program time:				
National	\$ 10,913	24.3%	\$ 10,992	24.0%
Local	7,673	17.1%	7,972	17.4%
	18,586	41.4%	18,964	41.3%
Advertising:				
National	3,424	7.6%	3,570	7.8%
Local	15,750	35.2%	15,730	34.2%

	19,174	42.8%	<b>19,300</b>	<b>42.0%</b>
Infomercials	1,603	3.6%	<b>1,487</b>	<b>3.2%</b>
Network	3,521	7.9%	<b>4,173</b>	<b>9.1%</b>
Other	1,909	4.3%	<b>1,971</b>	<b>4.3%</b>
Net broadcast revenue	\$ 44,793	100.0%	<b>\$ 45,895</b>	<b>100.0%</b>

**Internet Revenue**

	Three Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				% of Total Net Revenue	
Internet Revenue	\$ 6,686	\$ 7,800	\$ 1,114	16.7%	12.3%	13.8%

The increases in Internet revenue reflect improving overall economic conditions, a higher demand for Internet advertisements, and growth from our Internet acquisitions that typically generate revenues across all of our web-based platforms. Banner advertisements, including those on our station websites, increased \$1.1 million, including \$0.3 million of political revenue, primarily due to higher demand for placement from our advertisers and secondarily to rate increases.



**Table of Contents****Publishing Revenue**

	Three Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Publishing Revenue	\$ 3,024	\$ 3,024	\$	%	5.5%	5.3%

Publishing revenue increased from higher submission fees and book sales with Xulon Press that were offset by declines in subscription revenues from our print magazines as a result of a lower number of subscribers.

**Broadcast Operating Expenses**

	Three Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Broadcast Operating Expenses	\$ 29,198	\$ 30,628	\$ 1,430	4.9%	53.6%	54.0%
Same Station Net Broadcast Operating Expenses	\$ 29,117	\$ 30,452	\$ 1,335	4.6%		

Increases in broadcast operating expenses include higher variable costs associated with revenue growth. These costs include a \$0.7 million increase in personnel-related costs including commissions, a \$0.5 million increase in bad debt expense, a \$0.2 million increase in facility related costs, and a \$0.1 million increase in music license fees. These increases were partially offset by a reduction in advertising expense of \$0.1 million.

**Internet Operating Expenses**

	Three Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Internet Operating Expenses	\$ 5,080	\$ 5,825	\$ 745	14.7%	9.3%	10.3%

Internet operating expenses increased due to higher variable costs associated with revenue growth, including a \$0.4 million increase in personnel-related costs including commissions and a \$0.3 million increase in advertising expense.

**Publishing Operating Expenses**

	Three Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Publishing Operating Expenses	\$ 2,890	\$ 2,980	\$ 90	3.1%	5.3%	5.3%

Operating expenses for Xulon Press increased due to higher variable costs associated with revenue growth. These costs include an increase of \$0.2 million in personnel related costs including commissions. This was partially offset by a decrease in our publishing printing costs associated with reduced distribution levels of our print magazines.

**Corporate Expenses**

	Three Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Corporate Expenses	\$ 4,285	\$ 4,643	\$ 358	8.4%	7.9%	8.2%

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Corporate expenses include shared general and administrative services. Higher costs include a \$0.2 million increase in personnel-related costs primarily due to strategic new-hires, a \$0.1 million increase in non-cash stock-based compensation expense and a \$0.1 million increase in accounting and public reporting costs.

### Depreciation Expense

	<b>Three Months Ended September 30,</b>				<b>2011</b>		<b>2012</b>	
	2011	<b>2012</b>	Change \$	Change %	(Dollars in thousands)		% of Total Net Revenue	
Depreciation Expense	\$ 3,099	\$ 3,083	\$ (16)	(0.5)%	5.7%	5.4%		

Depreciation expense decreased due to lower levels of capital expenditures and lower levels of acquisitions, primarily in our broadcast operating segment as compared to prior years.

**Table of Contents****Amortization Expense**

	<b>Three Months Ended September 30,</b>					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Amortization Expense	\$ 633	\$ 494	\$ (139)	(22.0)%	1.2%	0.9%

The decrease in amortization expense reflects the impact of higher amortization recognized during 2011 for intangibles, such as advertising agreements, customer lists and domain names, which were acquired during that year and prior years with useful lives ranging from one to five years.

**(Gain)/Loss on Disposal of Assets**

	<b>Three Months Ended September 30,</b>					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
(Gain)/Loss on Disposal of Assets	\$ 32	\$ 587	\$ 555	1,734.4%	0.1%	1.0%

The net loss on disposal of assets for the three months ended September 30, 2012 and 2011 represents gains and losses from various fixed asset and equipment disposals including an additional loss associated with the write-off of a receivable from a prior station sale.

**Other Income (Expense), Net**

	<b>Three Months Ended September 30,</b>					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Interest Income	\$ 57	\$ 24	\$ (33)	(57.9)%	0.1%	%
Interest Expense	(6,826)	(6,127)	699	(10.2)%	(12.5)%	(10.8)%
Loss on Early Redemption of Long-Term Debt	(305)		(305)	(100.0)%	(0.6)%	%
Other Income (Expense)	3	60	57	1,900.0%	%	0.1%

Interest income represents earnings on excess cash. The decrease in interest expense is due to the lower principal balance outstanding on our 9<sup>5</sup>/<sub>8</sub>% Notes, partially offset by higher interest on the outstanding balances on our Revolver, line of credit with First California Bank and subordinated debt due to related parties. Other income and expense, net relates to royalty income from real estate properties.

Loss on early retirement of debt of \$0.3 million for the three months ended September 30, 2011 represents the redemption in each period of \$5.0 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$5.1 million, or at a price equal to 102<sup>7</sup>/<sub>8</sub>% of the face value.

**Provision for (Benefit from) Income Taxes**

	<b>Three Months Ended September 30,</b>					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Provision for (Benefit from) Income Taxes	\$ 526	\$ (971)	\$ (1,497)	(284.5)%	1.0 %	(1.7)%

In accordance with FASB ASC Topic 740 Income Taxes, our benefit from income taxes was \$1.0 million for the three months ended September 30, 2012 compared to a provision of \$0.5 million for the same period of the prior year. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 39.9% for the three months ended September 30, 2012 compared to 40.0% for the same period of the prior year. The effective tax rate for each period differs from the federal statutory income rate of 23.8% due to the effect of state income taxes, certain expenses that are not deductible for tax purposes, and changes in the valuation allowance from the utilization of certain state net operating loss carryforwards. During the three months ending September 30, 2012, we released a portion of the reserve related to state income taxes for which the statute of limitations has expired. In addition, we have re-evaluated our position related to the reasoning for

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establishing the reserve and determined that additions to the reserve are no longer applicable. Accordingly, as the statute of limitations expires for each tax year, an additional portion of the reserve will be released.

**Loss from Discontinued Operations, Net of Tax**

	<b>Three Months Ended September 30,</b>					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Loss from Discontinued Operations, Net of Tax	\$ (204)	\$ (39)	\$ 165	(80.8)%	(0.4) %	(0.1)%

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The loss from discontinued operations for the three months ended September 30, 2012 and 2011 relate to the operating results of Samaritan Fundraising that ceased operations in December 2011.

**Net Income (Loss)**

	<b>Three Months Ended September 30,</b>				<b>% of Total Net Revenue</b>	
	<b>2011</b>	<b>2012</b>	<b>Change \$</b>	<b>Change %</b>	<b>2011</b>	<b>2012</b>
	<i>(Dollars in thousands)</i>					
Net Income (Loss)	\$ 1,485	\$ 3,368	\$ 1,883	126.8%	2.7%	5.9%

Net income increased due primarily to higher revenue from political advertisements and our Internet business partially offset by higher operating costs. Additionally, there was a \$0.7 million decrease in interest expense and a \$1.5 million decrease in our tax provision as discussed above.

***Nine months ended September 30, 2012 compared to the nine months ended September 30, 2011***

The following factors affected our results of operations and cash flows for the nine months ended September 30, 2012 as compared to the same period of the prior year:

**Financing**

On May 21, 2012, we entered into a new Business Loan Agreement, Promissory Note and related loan documents with First California Bank (the FCB Loan). The FCB Loan is an unsecured, \$10.0 million fixed-term loan with a maturity date of June 15, 2014. At September 30, 2012, our leverage ratio was 4.97 to 1 and our interest coverage ratio was 2.18 to 1. We were in compliance with our debt covenants under the FCB Loan at September 30, 2012, and we remain in compliance.

On May 21, 2012, we entered into an affiliate line of credit with Roland S. Hinz, a Salem board member. Mr. Hinz committed to provide an unsecured revolving line of credit in a principal amount of up to \$6.0 million. On September 12, 2012, we amended and restated the original affiliate line of credit with Mr. Hinz to increase the unsecured revolving line of credit by \$6.0 million for a total line of credit of up to \$12.0 million. At December 31, 2011 and September 30, 2012, \$9.0 million and \$15.0 million, respectively, was outstanding under all Affiliate Lines of Credit.

On March 8, 2012, our Board of Directors authorized and declared a quarterly dividend in the amount of \$0.035 per share on Class A and Class B common stock. Common stock dividends of \$0.9 million, or \$0.035 per share, were paid on March 31, 2012, June 29, 2012 and September 28, 2012, respectively to all common stockholders of record. We anticipate paying quarterly common stock dividends in March, June, September and December of each year. Based on the number of shares currently outstanding, we expect to pay total annual common stock dividends of approximately \$3.4 million.

**Acquisitions**

On August 31, 2012, we completed the acquisition of radio station WLCC-AM, Tampa, Florida, for \$1.2 million.

On August 30, 2012, we purchased the Internet site SermonSpice.com for \$3.0 million.

On May 15, 2012, we purchased the Internet sites Churchangel.com and rchurch.com for \$0.2 million.

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On April 10, 2012, we completed the acquisition of radio station WKDL-AM in Warrenton, Virginia for \$30,000. We began programming the station upon the close of the transaction.

On January 13, 2012, we completed the acquisition of radio station KTNO-AM, Dallas, Texas for \$2.2 million. We began programming the station pursuant to a Time Brokerage Agreement with the current owner on November 1, 2011.

### **Dispositions**

On March 16, 2012, we completed the sale of radio station WBZS-AM in Pawtucket, Rhode Island for \$0.8 million in cash. The sale resulted in a pre-tax gain of \$0.2 million.



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	Nine Months Ended September 30,				2011		2012	
	2011	2012	Change \$	Change %	2011	2012	Change \$	Change %
	<i>(Dollars in thousands)</i>							
					% of Total Net Revenue			
Publishing Revenue	\$ 9,009	\$ 9,136	\$ 127	1.4%	5.6%	5.4%		

Publishing revenue increased from higher submission fees and book sales with Xulon Press that were partially offset by declines in subscription revenues from our print magazines as a result of a lower number of subscribers.

**Broadcast Operating Expenses**

	Nine Months Ended September 30,				2011		2012	
	2011	2012	Change \$	Change %	2011	2012	Change \$	Change %
	<i>(Dollars in thousands)</i>							
					% of Total Net Revenue			
Broadcast Operating Expenses	\$ 86,054	\$ 90,289	\$ 4,235	4.9%	53.4%	53.5%		
Same Station Net Broadcast Operating Expenses	\$ 85,684	\$ 89,567	\$ 3,883	4.5%				



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Broadcast operating expenses increased due to higher variable expenses associated with higher revenues, including a \$2.4 million increase in personnel-related costs including commissions, a \$0.7 million increase in facility related costs, a \$0.4 million increase in advertising expenses, a \$0.4 million increase in production and programming costs, a \$0.2 million increase in music license fees and a \$0.1 million increase in professional services partially offset by a reduction in bad debt expense of \$0.2 million and a decrease in repairs and maintenance costs of \$0.1 million.

**Internet Operating Expenses**

	Nine Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				% of Total Net Revenue	
Internet Operating Expenses	\$ 15,457	\$ 17,858	\$ 2,401	15.5%	9.6%	10.6%

Internet operating expenses increased due to higher variable expenses associated with higher revenues, including a \$1.5 million increase in personnel-related costs including commissions, a \$0.5 million increase in royalty expense, a \$0.3 million increase in advertising expense and a \$0.1 million increase in streaming and hosting.

**Publishing Operating Expenses**

	Nine Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				% of Total Net Revenue	
Publishing Operating Expenses	\$ 8,541	\$ 8,951	\$ 410	4.8%	5.3%	5.3%

Operating expenses for Xulon Press increased due to higher variable costs associated with revenue growth. These costs include an increase of \$0.3 million in personnel related costs including commissions and a \$0.1 million increase in advertising expense. This was offset by a decrease in our publishing printing costs associated with reduced distribution levels of our print magazines.

**Corporate Expenses**

	Nine Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				% of Total Net Revenue	
Corporate Expenses	\$ 13,040	\$ 14,314	\$ 1,274	9.8%	8.1%	8.5%

Corporate expenses include shared general and administrative services. Higher costs include a \$0.8 million in personnel-related costs primarily due to strategic new-hires, a \$0.2 million increase in non-cash stock-based compensation expense and a \$0.2 million increase in accounting and public reporting costs.

**Depreciation Expense**

	Nine Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				% of Total Net Revenue	
Depreciation Expense	\$ 9,398	\$ 9,150	\$ (248)	(2.6)%	5.8%	5.4%

Depreciation expense decreased due to lower levels of capital expenditures and acquisition related activity, primarily in our broadcast operating segment as compared to prior years.

**Amortization Expense**

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	Nine Months Ended September 30,				2011		2012	
	2011	2012	Change \$	Change %	% of Total Net Revenue		2011	2012
	<i>(Dollars in thousands)</i>							
Amortization Expense	\$ 1,835	\$ 1,625	\$ (210)	(11.4)%	1.1%		1.1%	1.0%

The decrease in amortization expense reflects the impact of higher amortization recognized during 2011 for intangibles, such as advertising agreements, customer lists and domain names that were acquired during that year and prior years with useful lives ranging from one to five years.

**Table of Contents****Impairment of Long-Lived Assets**

	2011	Nine Months Ended September 30,				2011	2012
		2012	Change \$	Change %	% of Total Net Revenue		
Impairment of Long-Lived Assets	\$	\$ 5,608	\$ 5,608	100.0%	%	3.3%	

During June 2012, based on changes in managements planned usage, land in Covina, CA was classified as held for sale and evaluated for impairment as of that date. In accordance with the authoritative guidance for impairment of long-lived assets held for sale, we determined the carrying value of the land exceeded the estimated fair value less cost to sell. We recorded an impairment charge of \$5.6 million associated with this land.

**(Gain)/Loss on Disposal of Assets**

	2011	Nine Months Ended September 30,				2011	2012
		2012	Change \$	Change %	% of Total Net Revenue		
(Gain)/Loss on Disposal of Assets	\$ (4,343)	\$ 563	\$ 4,906	(113.0)%	(2.7)%	0.3%	

The net gain on disposal of assets for the nine months ended September 30, 2012, includes a \$0.2 million pre-tax gain on the sale of WBZS-AM in Pawtucket, Rhode Island, partially offset by various fixed asset and equipment disposals including an additional loss associated with the write-off of a receivable from a prior station sale. The net gain on disposal of assets for the same period of the prior year includes a \$2.4 million pre-tax gain on the sale of KKMO-AM in Seattle, Washington and a \$2.1 million pre-tax gain on the sale of KXMX-AM in Los Angeles, California, partially offset by various fixed asset and equipment disposals.

**Other Income (Expense), Net**

	2011	Nine Months Ended September 30,				2011	2012
		2012	Change \$	Change %	% of Total Net Revenue		
Interest Income	\$ 154	\$ 83	\$ (71)	(46.1)%	0.1%	%	
Interest Expense	(21,125)	(18,787)	2,338	(11.1)%	(13.1)%	(11.1)%	
Loss on Early Redemption of Long-Term Debt	(1,395)	(893)	502	(36.0)%	(0.9)%	(0.5)%	
Other Income (Expense)	(20)	71	91	(455.0)%	%	%	

Interest income represents earnings on excess cash. The decrease in interest expense is due to the lower principal balance outstanding on our 9<sup>5</sup>/<sub>8</sub>% Notes, partially offset by higher interest on the outstanding balances on our Revolver and subordinated debt. Other income and expense, net relates to royalty income from real estate properties.

Loss on early retirement of debt of \$0.9 million for the nine months ended September 30, 2012 compared to \$1.4 million for the same period of the prior year represents the redemption in each period of \$17.5 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$18.0 million, or at a price equal to 103% of the face value and an open market repurchase of \$5.0 million of bonds in September 2011 for \$5.1 million, or at a price equal to 102<sup>7</sup>/<sub>8</sub>% of the face value.

**Provision for (Benefit from) Income Taxes**

	2011	Nine Months Ended September 30,				2011	2012
		2012	Change \$	Change %	% of Total Net Revenue		
Provision for (Benefit from) Income Taxes	\$ 3,405	\$ (1,768)	\$ (5,173)	(151.9)%	2.1%	(1.0)%	

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In accordance with FASB ASC Topic 740 Income Taxes, our benefit from income taxes was \$1.8 million for the nine months ended September 30, 2012 compared to a tax provision of \$3.4 million for the same period of the prior year. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 237.3% for the nine months ended September 30, 2012 compared to 39% for the same period of the prior year. The effective tax rate for each period differs from the federal statutory income rate of 35.0% due to the effect of state income taxes, certain expenses that are not deductible for tax purposes, and changes in the valuation allowance from the utilization of certain state net operating loss carryforwards. During the nine months ending September 30, 2012, we released a portion of the reserve related to state income taxes for which the statute of limitations has expired. In addition, we have re-evaluated our position related to the reasoning for establishing the reserve and determined that additions to the reserve are no longer applicable. Accordingly, as the statute of limitations expires for each tax year, an additional portion of the reserve will be released.

**Table of Contents****Loss from Discontinued Operations, Net of Tax**

	Nine Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Loss from Discontinued Operations, Net of Tax	\$ (161)	\$ 94	\$ 67	(41.5)%	(0.1)%	(0.1)%

The loss from discontinued operations for the nine months ended September 30, 2012 and 2011 relate to the operating results of Samaritan Fundraising that ceased operations in December 2011.

**Net Income (Loss)**

	Nine Months Ended September 30,					
	2011	2012	Change \$	Change %	2011	2012
	<i>(Dollars in thousands)</i>				<i>% of Total Net Revenue</i>	
Net Income (Loss)	\$ 5,172	\$ 2,419	\$ (2,753)	(53.2)%	3.2%	1.4%

The decrease in net income is due to a \$10.0 million decrease in net operating income as a result of higher operating costs as discussed above, including the \$5.6 million impairment of long-lived assets that was partially offset by a \$1.6 million decrease in interest expense and a \$3.7 million decrease in our tax provision.

**SAME STATION DEFINITION**

In the discussion of our results of operations below, we compare our results between periods on an as reported basis (that is, the results of operations of all radio stations and network formats owned or operated at any time during either period) and on a same station basis. With regard to fiscal quarters, we include in our same station comparisons the results of operations of radio stations or radio station clusters and networks that we own or operate in the same format during the quarter, as well as the corresponding quarter of the prior year. Same station results for a full year are based on the sum of the same station results for the four quarters of that year.

**NON-GAAP FINANCIAL MEASURES**

The performance of a radio broadcasting company is customarily measured by the ability of its stations to generate station operating income. We define station operating income ( SOI ) as net broadcast revenue less broadcast operating expenses. Accordingly, changes in net broadcast revenue and broadcast operating expenses, as explained above, have a direct impact on changes in SOI.

SOI is not a measure of performance calculated in accordance with GAAP. SOI should be viewed as a supplement to and not a substitute for our results of operations presented on the basis of GAAP. Management believes that SOI is a useful non-GAAP financial measure to investors, when considered in conjunction with operating income, the most directly comparable GAAP financial measure, because it is generally recognized by the radio broadcasting industry as a tool in measuring performance and in applying valuation methodologies for companies in the media, entertainment and communications industries. This measure is used by investors and analysts who report on the industry to provide comparisons between broadcasting groups. Additionally, our management uses SOI as one of the key measures of operating efficiency, profitability and our internal review associated with our impairment analysis of indefinite-lived intangible assets. SOI does not purport to represent cash provided by operating activities. Our statement of cash flows presents our cash flow activity and our income statement presents our historical performance prepared in accordance with GAAP. SOI as defined by and used by our company is not necessarily comparable to similarly titled measures employed by other companies.

**Three months ended September 30, 2012 compared to the three months ended September 30, 2011**

**STATION OPERATING INCOME.** SOI decreased \$0.3 million, or 2.1%, to \$15.3 million for the three months ended September 30, 2012, compared to \$15.6 million for the same period of the prior year. As a percentage of net broadcast revenue, SOI decreased to 33.3% for the three months ended September 30, 2012 from 34.8% for the same period of the prior year. On a same station basis, SOI decreased \$0.3 million, or 2.4%, to \$15.3 million for the three months ended September 30, 2012 from \$15.6 million for the same period of the prior year. As a percentage of same station net broadcast revenue, same station SOI decreased to 33.4% for the three months ended September 30, 2012 from 35.0% for the same period of the prior year. The decline in SOI is primarily due to higher operating expenses, including personnel related costs during the

three months ending September 30, 2012 compared to the same period of the prior year.

**Table of Contents****Nine months ended September 30, 2012 compared to the nine months ended September 30, 2011**

**STATION OPERATING INCOME.** SOI decreased \$1.0 million, or 2.0%, to \$45.9 million for the nine months ended September 30, 2012, compared to \$46.9 million for the same period of the prior year. As a percentage of net broadcast revenue, SOI decreased to 33.7% for the nine months ended September 30, 2012 from 35.3% for the same period of the prior year. On a same station basis, SOI decreased \$0.8 million, or 1.7%, to \$45.9 million for the nine months ended September 30, 2012 from \$46.7 million for the same period of the prior year. As a percentage of same station net broadcast revenue, same station SOI decreased to 33.9% for the nine months ended September 30, 2012 from 35.3% for the same period of the prior year. The decline in SOI is primarily due to higher operating expenses, including personnel related costs during the three months ending September 30, 2012 compared to the same period of the prior year.

The following table provides a reconciliation of SOI (a non-GAAP financial measure) to operating income (as presented in our condensed consolidated financial statements) for the three and nine months ended September 30, 2011 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2012	2011	2012
	<i>(Dollars in thousands)</i>			
Station Operating Income	\$ 15,595	\$ 15,267	\$ 46,875	\$ 45,935
Plus Internet revenue	6,686	7,800	19,168	23,269
Plus publishing revenue	3,024	3,024	9,009	9,136
Less Internet operating expenses	(5,080)	(5,825)	(15,457)	(17,858)
Less publishing operating expenses	(2,890)	(2,980)	(8,541)	(8,951)
Less corporate expenses	(4,285)	(4,643)	(13,040)	(14,314)
Less depreciation and amortization	(3,732)	(3,577)	(11,233)	(10,775)
Less impairment of long-lived assets				(5,608)
Less gain (loss) on disposal of assets	(32)	(587)	4,343	(563)
Operating income from continuing operations	\$ 9,286	\$ 8,479	\$ 31,124	\$ 20,271
Plus interest income	57	24	154	83
Less interest expense	(6,826)	(6,127)	(21,125)	(18,787)
Less loss on early redemption of long-term debt	(305)		(1,395)	(893)
Less other income (expense), net	3	60	(20)	71
Less provision for (benefit from) income taxes	(526)	971	(3,405)	1,768
Less discontinued operations	(204)	(39)	(161)	(94)
Net income	\$ 1,485	\$ 3,368	\$ 5,172	\$ 2,419

**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to acquisitions and upgrades of radio station and network assets, revenue recognition, allowance for doubtful accounts, goodwill and other non-intangible assets, uncertain tax positions, valuation allowance (deferred taxes), long-term debt and debt covenant compliance, and stock-based compensation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following accounting policies and the related judgments and estimates are critical accounting policies that affect the preparation of our condensed consolidated financial statements.

**Accounting for acquisitions and upgrades of radio station and network assets**

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A majority of our radio station acquisitions have consisted primarily of the FCC licenses to broadcast in a particular market. We often do not acquire the existing format, or we change the format upon acquisition when we find it beneficial. As a result, a substantial portion of the purchase price for the assets of a radio station is allocated to the broadcast license. It is our policy generally to retain third-party appraisers to value significant radio stations, networks, Internet and publishing properties. The allocations assigned to acquired broadcast licenses and other assets are subjective by their nature and require our careful consideration and judgment. We believe the allocations represent appropriate estimates of the fair value of the assets acquired. As part of the valuation



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and appraisal process, the third-party appraisers prepare reports that assign values to the various asset categories in our financial statements. Our management reviews these reports and determines the reasonableness of the assigned values used to record the acquisition at the close of the transaction.

We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC broadcast licenses. Our policy is to capitalize costs incurred up to the point where the project is complete, at which time we transfer the costs to the appropriate fixed asset and/or intangible asset categories. When the completion of a project is contingent upon FCC or other regulatory approval, we assess the probable future benefit of the asset at the time that it is recorded and monitor it through the FCC or other regulatory approval process. In the event the required approval is not considered probable or the project is abandoned, we write-off the capitalized costs of the project.

### ***Revenue recognition***

Revenues are recognized when pervasive evidence of an arrangement exists, delivery has occurred or the service has been rendered, the price to the customer is fixed or determinable and collection of the arrangement fee is reasonably assured.

Revenues from radio programs and commercial advertising are recognized when the program or advertisement is broadcast. Revenue is reported net of agency commissions, which are calculated based on a stated percentage applied to gross billing. Our customers principally include not-for-profit charitable organizations and commercial advertisers. Revenue from the sale of products and services are recognized when the products are shipped and the services are rendered. Revenues from the sale of advertising in our magazines are recognized upon publication. Revenue from the sale of subscriptions to our publications is recognized over the life of the subscription. Revenue from book sales are recorded when shipment occurs.

### ***Multiple-Deliverables***

We may enter bundled advertising agreements that include spot advertisements on our radio stations, Internet banner placements, print magazine advertisements and booth space at specific events or some combination thereof. The multiple deliverables contained in each agreement are accounted for separately over their respective delivery period provided that they are separate units of accounting. The selling price used for each deliverable is based on vendor specific objective evidence if available or estimated selling price if vendor specific objective evidence is not available. Objective evidence of fair value includes the price charged for each element when it is sold separately. The estimated selling price is the price that we would transact if the deliverable were sold regularly on a standalone basis. Arrangement consideration is allocated at the inception of each arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverable's selling price.

### ***Barter transactions***

We may provide advertising time in exchange for certain products, supplies and services. The terms of the exchanges generally permit for the preemption of such broadcast time in favor of advertisers who purchase time on regular terms. We include the value of such exchanges in both net broadcasting revenues and broadcast operating expenses. The value recorded for barter revenues is based upon management's estimate of the fair value of the products, supplies and services received.

Advertising time that our radio stations exchange for goods and or services is recorded as barter revenue when the advertisement is broadcast at an amount equal to our estimate fair value of what was received. The value of the goods and services received in such barter transactions is charged to expense when used. Barter advertising revenue for the three and nine months ended September 30, 2012 was approximately \$1.4 million and \$4.0 million, respectively, and \$1.4 million and \$4.1 million, respectively, for the same period of the prior year. Barter expenses were approximately the same as barter revenue for each period.

### ***Allowance for doubtful accounts***

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. An analysis is performed by applying various percentages based on the age of the receivable and other subjective and historical analysis. A considerable amount of judgment is required in assessing the likelihood of ultimate realization of these receivables including the current creditworthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.



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**Table of Contents*****Accounting for discontinued operations***

We regularly review underperforming assets to determine if a sale might be a better way to monetize the assets. When a station, group of stations, or other asset groups are considered for sale, we review the transaction to determine if or when the entity qualifies as a discontinued operation in accordance with the criteria of Financial Accounting Standards Board Accounting Standards Codification ( FASB ASC ) Topic 205-20 Discontinued Operations. This pronouncement specifies that the operations and cash flow of the entity disposed of, or to be sold, have or will be eliminated from the ongoing operations as a result of the disposal and that we will not have significant continuing involvement in the operations after the disposal transaction. For our radio stations, we define a cluster as a group of radio stations operating in the same geographic market, sharing the same building, equipment, and managed by a single general manager. The cluster level is the lowest level for which discrete financial information and cash flows are available and the level reviewed by management to analyze operating results. General Managers are compensated based on the results of their cluster as a whole, not the results of any individual radio stations. We have determined that a radio market qualifies for a discontinued operation when management, having the authority to approve the action, commits to a plan to sell the asset (disposal group), the sale is probable, and the sale will result in the exit of a particular geographic market.

During the 4th quarter of 2011, based on operating results that did not meet expectations, we ceased operating Samaritan Fundraising as of December 31, 2011. Samaritan Fundraising, reported in our Internet operations, was a web-based fundraising products company operating from a single facility in Fairfax, VA, under the control of one general manager. As a result of our decision to close operations, there will be no material cash flows associated with this entity and we have no ongoing or further involvement in the operations of this entity. We have reported the operating results and net assets of this entity as a discontinued operation for all prior periods presented.

***Goodwill and other indefinite-lived intangible assets***

Approximately 70% of our total assets as of September 30, 2012, consist of indefinite-lived intangible assets, such as broadcast licenses, goodwill and mastheads, the value of which depends significantly upon the operating results of our businesses. In the case of our radio stations, we would not be able to operate the properties without the related FCC license for each property. Broadcast licenses are renewed with the FCC every eight years for a nominal cost that is expensed as incurred. We continually monitor our stations' compliance with the various regulatory requirements. Historically, all of our broadcast licenses have been renewed at the end of their respective periods, and we expect that all broadcast licenses will continue to be renewed in the future. Accordingly, we consider our broadcast licenses to be indefinite-lived intangible assets in accordance with FASB ASC Topic 350, Intangibles Goodwill and Other. Broadcast licenses account for approximately 94% of our indefinite-lived intangible assets. Goodwill and magazine mastheads account for the remaining 6%. We do not amortize goodwill or other indefinite-lived intangible assets, but rather test for impairment at least annually or more frequently if events or circumstances indicate that an asset may be impaired.

We complete our annual impairment tests in the fourth quarter of each year. We believe that our estimate of the value of our broadcast licenses, mastheads, and goodwill is a critical accounting estimate as the value is significant in relation to our total assets, and our estimates incorporate variables and assumptions that are based on past experiences and judgment about future operating performance of our markets and business segments. The fair value measurements for our indefinite-lived intangible assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. The unobservable inputs are defined in FASB ASC Topic 820 Fair Value Measurements and Disclosures as Level 3 inputs discussed in detail in Note 13 to our Condensed Consolidated Financial Statements.

***Impairment losses long-lived assets***

We account for property, plant and equipment in accordance with FASB ASC Topic 360-10, Property, Plant and Equipment. We periodically review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. In accordance with the authoritative guidance for impairment of long-lived assets we must estimate the fair value of assets when events for circumstances indicate that they may be impaired. The fair value measurements of our long-lived assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material.

***Partial self-insurance on employee health plan***

We provide health insurance benefits to eligible employees under a self-insured plan whereby the company pays actual medical claims subject to certain stop loss limits. We record self-insurance liabilities based on actual claims filed and an estimate of those claims incurred but not reported. Any projection of losses concerning our liability is subject to a high degree of variability. Among the causes of this variability are unpredictable

external factors such as future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should the actual amount of claims increase or decrease beyond what was anticipated we may need to adjust our future reserves.

**Table of Contents*****Income taxes and uncertain tax positions***

We account for income taxes in accordance with FASB ASC Topic 740 Income Taxes. We recorded an increase in our unrecognized tax benefits of \$0.2 million as of September 30, 2011 and a net decrease of \$2.1 million as of September 30, 2012. At December 31, 2011, we had \$3.9 million in liabilities for unrecognized tax benefits. Included in this liability amount were \$0.1 million accrued for the related interest, net of federal income tax benefits, and \$0.02 million for the related penalty recorded in income tax expense on our Condensed Consolidated Statements of Operations. During the nine months ending September 30, 2012, we released a portion of the reserve related to state income taxes for which the statute of limitations has expired. In addition, we have re-evaluated our position related to the reasoning for establishing the reserve and determined that additions to the reserve are no longer applicable. Accordingly, as the statute of limitations expires for each tax year, an additional portion of the reserve will be released.

***Valuation allowance (deferred taxes)***

For financial reporting purposes, we recorded a valuation allowance of \$0.2 million as of September 30, 2012 to offset a portion of the deferred tax assets related to the state net operating loss carryforwards. Management regularly reviews our financial forecasts in an effort to determine our ability to utilize the net operating loss carryforwards for tax purposes. Accordingly, the valuation allowance is adjusted periodically based on management's estimate of the benefit the company will receive from such carryforwards.

***Fair value accounting***

FASB ASC Topic 820 Fair Value Measurements and Disclosures established a single definition of fair value in generally accepted accounting principles and expanded disclosure requirements about fair value measurements. The provision applies to other accounting pronouncements that require or permit fair value measurements. We adopted the fair value provisions for financial assets and financial liabilities effective January 1, 2008. The adoption had a material impact on our consolidated financial position, results of operations and cash flows. We adopted fair value provisions for nonfinancial assets and nonfinancial liabilities effective January 1, 2009. This includes applying the fair value concept to (i) nonfinancial assets and liabilities initially measured at fair value in business combinations; (ii) reporting units or nonfinancial assets and liabilities measured at fair value in conjunction with goodwill impairment testing; (iii) other nonfinancial assets measured at fair value in conjunction with impairment assessments; and (iv) asset retirement obligations initially measured at fair value. The adoption of the fair value provisions of FASB ASC Topic 820 to nonfinancial assets and nonfinancial liabilities did not have a material impact on our consolidated financial position, results of operations or cash flows.

The fair value provisions include guidance on how to estimate the fair value of assets and liabilities in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to normal market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate.

The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market, and the characteristics specific to the transaction. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have less (or no) pricing observability and a higher degree of judgment utilized in measuring fair value. Please refer to Note 13 Fair Value Accounting for a further discussion.

***Stock-based compensation***

We account for stock-based compensation under the provisions of FASB ASC Topic 718 Compensation Stock Compensation. We record equity awards with stock-based compensation measured at the fair value of the award as of the grant date. We determine the fair value of our options using the Black-Scholes option-pricing model that requires the input of highly subjective assumptions, including the expected stock price volatility and expected term of the options granted. The exercise price for options is equal to the closing market price of Salem Communications common stock as of the date of grant. We use the straight-line attribution method to recognize share-based compensation costs over the expected service period of the award. Upon exercise, cancellation, forfeiture, or expiration of stock options, or upon vesting or forfeiture of restricted stock awards, deferred tax assets for options and restricted stock awards with multiple vesting dates are eliminated for each vesting period on a first-in, first-out basis as if each vesting period was a separate award.



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### ***Use of estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas for which management uses estimates include, but are not limited to: (1) asset impairments, including broadcasting licenses, goodwill and other indefinite-lived intangible assets; (2) income tax valuation allowances; (3) uncertain tax positions; (4) allowance for doubtful accounts; (5) self-insurance reserves; (6) fair value of equity awards; (7) estimated lives for tangible and intangible assets; (8) fair value measurements; and (9) contingency reserves. These estimates require the use of judgment as future events and the effect of these events cannot be predicted with certainty. The estimates will change as new events occur, as more experience is acquired and as more information is obtained. We evaluate and update our assumptions and estimates on an ongoing basis and we may consult outside experts to assist as considered necessary.

### **LIQUIDITY AND CAPITAL RESOURCES**

We have historically financed acquisitions through borrowings, including borrowings under credit facilities and, to a lesser extent, from operating cash flow and selected asset dispositions. We expect to fund future acquisitions from cash on hand, proceeds from debt and equity offerings, borrowings under our credit facilities, operating cash flow and possibly through the sale of income-producing assets. We have funded, and will continue to fund, expenditures for operations, administrative expenses, capital expenditures and debt service from operating cash flow, borrowings allowed under our credit facilities and subordinated debt, and if necessary, proceeds from the sale of selected assets or radio stations.

#### ***Cash Flows***

Cash and cash equivalents increased \$0.1 million to \$0.2 million as of September 30, 2012 compared to \$0.1 million as of the December 31, 2011. Working capital decreased \$7.8 million to (\$2.3) million as of September 30, 2012, compared to \$5.5 million as of December 31, 2011 primarily due to the short-term affiliate lines of credit.

The following events impacted our liquidity and capital resources during the nine months ended September 30, 2012:

Capital expenditures increased \$0.5 million to \$6.4 million from \$5.9 million for same period of the prior year;

Our Days Sales Outstanding (DSO) improved to 68 days as of September 30, 2012 from 69 days for the same period of the prior year;

Cash paid for acquisitions was \$6.5 million;

Our net cash outflows toward outstanding debt decreased \$22.6 million to \$4.4 million from \$27.0 million for the same period of the prior year due to additional funding from the new First California Bank loan and new affiliate lines of credit, both of which have favorable interest rates as compared to our existing debt;

We paid common stock dividends of \$2.6 million cash, or \$0.10 per share, during the nine months ending September 2012; and

Our net income from continuing operations decreased \$2.8 million to \$2.4 million from \$5.3 million for the same period of the prior year.

#### ***Credit Facilities***

##### ***Senior Credit Facility***

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On December 1, 2009, our parent company, Salem Communications Corporation, entered into a Revolver. We amended the Revolver on November 1, 2010 to increase the borrowing capacity from \$30 million to \$40 million. The amendment allows us to use borrowings under the Revolver, subject to the Available Amount as defined by the terms of the Credit Agreement, to redeem applicable portions of the 5.9% Notes. The calculation of the Available Amount also pertains to the payment of dividends when the leverage ratio is above 5.0 to 1.



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On November 15, 2011, we completed the Second Amendment of our Revolver to among other things, (1) extend the maturity date from December 1, 2012 to December 1, 2014 (2) change the interest rate applicable to LIBOR or the Wells Fargo base rate plus a spread to be determined based on our leverage ratio, (3) allow us to borrow and repay unsecured indebtedness provided certain conditions are met and (4) include step-downs related to our leverage ratio covenant. We incurred \$0.5 million in fees to complete this amendment, which are being amortized over the remaining term of the agreement. The applicable interest rate relating to the amended credit agreement is LIBOR plus a spread of 3.0% per annum or the Base Rate plus a spread of 1.25% per annum, which is adjusted based on our leverage ratio. If an event of default occurs, the interest rate may increase by 2.0% per annum. Details of the change in our rate based on our leverage ratio are as follows:

Consolidated Leverage Ratio	Base Rate	Eurodollar Rate Loans	Applicable Fee Rate
Less than 3.25 to 1.00	0.75%	2.25%	0.40%
Greater than or equal to 3.25 to 1.00 but less than 4.50 to 1.00	0.75%	2.50%	0.50%
Greater than or equal to 4.50 to 1.00 but less than 6.00 to 1.00	1.25%	3.00%	0.60%
Greater than or equal to 6.00 to 1.00	2.25%	3.50%	0.75%

The Revolver includes a \$5 million subfacility for standby letters of credit and a subfacility for swingline loans of up to \$5 million, subject to the terms and conditions of the credit agreement relating to the Revolver. In addition to interest charges outlined above, we pay a commitment fee on the unused balance based on the Applicable Fee Rate in the above table. If an event of default occurs, the interest rate may increase by 2.00% per annum. Amounts outstanding under the Revolver may be paid and then reborrowed at Salem's discretion without penalty or premium. At September 30, 2012 the blended interest rate on amounts outstanding under the Revolver was 3.29%. We believe that our borrowing capacity under the Revolver allows us to meet our ongoing operating requirements, fund capital expenditures, and satisfy our debt service requirements.

With respect to financial covenants, the credit agreement includes a maximum leverage ratio of 6.25 to 1.0 and a minimum interest coverage ratio of 1.5 to 1. The credit agreement also includes other negative covenants that are customary for credit facilities of this type, including covenants that, subject to exceptions described in the Credit Agreement, restrict the ability of Salem and the guarantors: (i) to incur additional indebtedness; (ii) to make investments; (iii) to make distributions, loans or transfers of assets; (iv) to enter into, create, incur, assume or suffer to exist any liens; (v) to sell assets; (vi) to enter into transactions with affiliates; (vii) to merge or consolidate with, or dispose of all or substantially all assets to, a third party; (viii) to prepay indebtedness; and (ix) to pay dividends. As of September 30, 2012, our leverage ratio was 4.97 to 1 and our interest coverage ratio was 2.18 to 1. We were in compliance with our debt covenants under the Revolver at September 30, 2012, and we remain in compliance.

Our parent company, Salem Communications Corporation, has no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several, and any subsidiaries of the parent company other than the subsidiary guarantors are minor.

**Senior Secured Second Lien Notes**

On December 1, 2009, we issued \$300.0 million principal amount of 9<sup>5</sup>/<sub>8</sub>% Notes at a discount for \$298.1 million resulting in an effective yield of 9.75%. Interest is due and payable on June 15 and December 15 of each year, commencing June 15, 2010 until maturity. We are not required to make principal payments on the 9<sup>5</sup>/<sub>8</sub>% Notes that are due in full in December 2016. The 9<sup>5</sup>/<sub>8</sub>% Notes are guaranteed by all of our existing domestic restricted subsidiaries. Upon issuance, we were required to pay \$28.9 million per year in interest on the then outstanding 9<sup>5</sup>/<sub>8</sub>% Notes. As of December 31, 2011 and September 30, 2012, accrued interest on the 9<sup>5</sup>/<sub>8</sub>% Notes was \$1.0 million and \$6.2 million, respectively. The discount is being amortized to interest expense over the term of the 9<sup>5</sup>/<sub>8</sub>% Notes based on the effective interest method. For each of the three and nine months ended September 30, 2012 and 2011, approximately \$48,000 and \$0.1 million, respectively, of the discount has been recognized as interest expense.

On June 1, 2012, we redeemed \$17.5 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$18.0 million, or at a price equal to 103% of the face value. This transaction resulted in a \$0.9 million pre-tax loss on the early retirement of debt, including approximately \$80,000 of unamortized discount and \$0.3 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

On December 12, 2011, we redeemed \$12.5 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$12.9 million, or at a price equal to 103% of the face value. This transaction resulted in a \$0.8 million pre-tax loss on the early retirement of debt, including approximately \$62,000 of unamortized discount and \$0.3 million of bond issues costs associated with the 9<sup>5</sup>/<sub>8</sub>% Notes.

On September 6, 2011, we repurchased \$5.0 million of the 9<sup>5</sup>/<sub>8</sub>% Notes for \$5.1 million, or at a price equal to 102<sup>7</sup>/<sub>8</sub>% of the face value. This transaction resulted in a \$0.3 million pre-tax loss on the early retirement of debt, including approximately \$26,000 of unamortized discount and

\$0.1 million of bond issues costs associated with the  $9\frac{5}{8}\%$  Notes.

On June 1, 2011, we redeemed \$17.5 million of the  $9\frac{5}{8}\%$  Notes for \$18.0 million, or at a price equal to 103% of the face value. This transaction resulted in a \$1.1 million pre-tax loss on the early retirement of debt, including \$0.1 million of unamortized discount and \$0.5 million of bond issues costs associated with the  $9\frac{5}{8}\%$  Notes.

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Information regarding repurchases and redemptions of the 9<sup>5</sup>/<sub>8</sub>% Notes are as follows:

Date	Principal Redeemed/Repurchased	Premium Paid	Unamortized Discount	Bond Issue Costs
	<i>(Dollars in thousands)</i>			
June 1, 2012	\$ 17,500	\$ 525	\$ 80	\$ 287
December 12, 2011	12,500	375	62	337
September 6, 2011	5,000	144	26	135
June 1, 2011	17,500	525	93	472
December 1, 2010	12,500	375	70	334
June 1, 2010	17,500	525	105	417

The carrying value of the 9<sup>5</sup>/<sub>8</sub>% Notes was \$233.8 million and \$216.5 million at December 31, 2011 and September 30, 2012, respectively.

**Subordinated Credit Facility with First California Bank**

On May 21, 2012, we entered into a new Business Loan Agreement, Promissory Note and related loan documents with First California Bank (the FCB Loan). The FCB Loan is an unsecured, \$10.0 million fixed-term loan with a maturity date of June 15, 2014. The interest rate for the FCB Loan (Interest Rate) is variable and shall be equal to the greater of: (a) 4.250% or (b) the Wall Street Journal Prime Rate as published in The Wall Street Journal and reported by FCB plus 1%.

We are required to repay the FCB Loan as follows: (a) twenty three (23) consecutive monthly interest payments based upon the then-current principal balance outstanding at the then-current Interest Rate commencing on September 15, 2012; (b) seven quarterly consecutive principal payments of \$1.25 million each commencing on September 15, 2012; and (c) one final principal and interest payment on June 15, 2014 of all outstanding and unpaid interest and principal as of such maturity date. The FCB Loan may be prepaid at any time subject to a minimum interest charge of Fifty Dollars (\$50). If an event of default occurs on the FCB Loan, the Interest Rate may increase by 5.00% per annum. At September 30, 2012, the outstanding principal balance on the FCB loan was \$8.8 million with approximately \$26,900 of accrued interest.

The FCB Loan is unsecured and is subordinate in all respects to our existing Revolver. Our obligations under the FCB Loan are guaranteed by personal guaranties executed in favor of FCB by Edward G. Atsinger III, Salem's CEO and board member, Mr. Stuart Epperson, Salem's Chairman of the Board and board member and trusts controlled by these two individuals. With respect to financial covenants, the FCB Loan includes a maximum leverage ratio of 6.25 to 1.0 through December 31, 2012, 6.00 to 1.0 from January 1, 2013 through December 31, 2013, and 5.50 to 1.0 from January 1, 2014 through maturity; and a minimum interest coverage ratio of 1.5 to 1. The FCB Loan also includes other customary negative covenants that restrict the ability of Salem and the guarantors: (i) to incur additional indebtedness; (ii) to make investments; (iii) to make distributions, loans or transfers of assets; (iv) to enter into, create, incur, assume or suffer to exist any liens; (v) to sell assets; (vi) to enter into transactions with affiliates; (vii) to merge or consolidate with, or dispose of all or substantially all assets to, a third party; (viii) to prepay indebtedness; and (ix) to pay dividends. At September 30, 2012, our leverage ratio was 4.97 to 1 and our interest coverage ratio was 2.18 to 1. We were in compliance with our debt covenants under the FCB Loan at September 30, 2012, and we remain in compliance.

**Subordinated Lines of Credit with Related Parties**

On November 17, 2011, we entered into Affiliate Lines of Credit with Edward G. Atsinger III, Chief Executive Officer and director of Salem, and Stuart W. Epperson, Chairman of Salem's board of directors. Pursuant to the related agreements, Mr. Epperson has committed to provide an unsecured revolving line of credit to Salem in a principal amount of up to \$3 million, and Mr. Atsinger has committed to provide an unsecured revolving line of credit in a principal amount of up to \$6 million. On May 21, 2012, we entered into a line of credit with Roland S. Hinz, a Salem board member. Mr. Hinz committed to provide an unsecured revolving line of credit (LOC) in a principal amount of up to \$6.0 million. On September 12, 2012, we amended and restated the original line of credit with Mr. Hinz to increase the unsecured revolving line of credit by \$6.0 million for a total line of credit of up to \$12.0 million (together, the Affiliate Lines of Credit).

The proceeds of the Affiliate Lines of Credit may be used to repurchase a portion of Salem's outstanding 9<sup>5</sup>/<sub>8</sub>% Notes. Outstanding amounts under each Affiliate Line of Credit will bear interest at a rate equal to the lesser of (1) 5% per annum and (2) the maximum rate permitted for subordinated debt under the Revolver referred to above plus 2% per annum. Interest is payable at the time of any repayment of principal. In addition, outstanding amounts under each Affiliate Line of Credit must be repaid within three months from the time that such amounts are borrowed, with the exception of the LOC with Mr. Hinz, which must be repaid within six (6) months from the time that such amounts are borrowed. The Affiliate Lines of Credit do not contain any covenants. At December 31, 2011 and September 30, 2012, \$9.0 million and \$15.0

million, respectively, was outstanding under these Affiliate Lines of Credit.

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Because the transactions with Mrs. Atsinger, Epperson and Hinz described above constitute related party transactions, the nominating and corporate governance committee (the Committee) of Salem's board of directors approved the entry by Salem into the LOC and any definitive credit agreements associated therewith. As part of its consideration, the Committee concluded that the terms of the LOC were more favorable to Salem as compared to terms of lines of credit available from unaffiliated third parties.

**Summary of long-term debt obligations**

Long-term debt consisted of the following:

	As of December 31, 2011	As of September 30, 2012
	<i>(Dollars in thousands)</i>	
Revolver under senior credit facility	\$ 31,000	\$ 29,369
9 <sup>5</sup> / <sub>8</sub> % senior secured second lien notes due 2016	233,846	216,561
Subordinated debt		8,750
Subordinated debt due to related parties	9,000	15,000
Capital leases and other loans	957	890
	274,803	270,570
Less current portion	(9,124)	(20,115)
	\$ 265,679	\$ 250,455

In addition to the amounts listed above, we also have interest payments related to our long-term debt as follows as of September 30, 2012:

Outstanding borrowings of \$29.4 million under the Revolver, with interest payments due at LIBOR plus 3.00% or at prime rate plus 1.25%;

\$217.5 million 9<sup>5</sup>/<sub>8</sub>% Notes with semi-annual interest payments at an annual rate of 9<sup>5</sup>/<sub>8</sub>%;

Outstanding borrowings of \$10.0 million on the FCB loan with interest payments due at the greater of: (a) 4.250% or (b) the Wall Street Journal Prime Rate as published in The Wall Street Journal and reported by FCB plus 1%;

Outstanding borrowings of \$15.0 million due to related parties at an interest rate equal to the lesser of (1) 5% per annum and (2) the maximum rate permitted for subordinated debt under the Revolver plus 2% per annum; and

Commitment fee of 0.60% on the unused portion of the Revolver.

**Other Debt**

We have several capital leases related to various office equipment. The obligation recorded at December 31, 2011 and September 30, 2012 represents the present value of future commitments under the lease agreements.

**Impairment losses on goodwill and indefinite-lived intangible assets**

Under FASB ASC Topic 350 Intangibles Goodwill and Other, indefinite-lived intangibles, including broadcast licenses, goodwill and mastheads are not amortized but instead are tested for impairment at least annually, or more frequently if events or circumstances indicate that there may be an impairment. Impairment is measured as the excess of the carrying value of the indefinite-lived intangible asset over its fair value. Intangible

assets that have finite useful lives continue to be amortized over their useful lives and are measured for impairment if events or circumstances indicate that they may be impaired. Impairment losses are recorded as operating expenses. We have incurred significant impairment losses in prior periods with regard to our indefinite-lived intangible assets.

The valuation of intangible assets is subjective and based on estimates rather than precise calculations. The fair value measurements of our indefinite-lived intangible assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material. Given the current economic environment and uncertainties that can negatively impact our business, there can be no assurance that our estimates and assumptions made for the purpose of our indefinite-lived intangible fair value estimates will prove to be accurate.

***Impairment losses long-lived assets***

We account for property, plant and equipment in accordance with FASB ASC Topic 360-10, Property, Plant and Equipment . We periodically review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable.

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During June 2012, based on changes in managements intended use of land in Covina, CA we reclassified the land from our broadcast segment to assets held for sale and evaluated for impairment as of that date. In accordance with the authoritative guidance for impairment of long-lived assets held for sale, we determined the carrying value of the land exceeded the estimated fair value less cost to sell. We estimated the fair value of the land based on our estimated future cash flows expected from the sale of the land to a willing party less our estimated closing costs. As a result of our analysis, we recorded an impairment charge of \$5.6 million associated with the land. The fair value measurements of our long-lived assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material.

## **OFF-BALANCE SHEET ARRANGEMENTS**

We have, from time to time, divested certain of our radio stations and assets. In connection with these divestitures, we often provide representations, warranties and/or indemnities to cover various risks and unknown liabilities, such as environmental liabilities. We cannot estimate the potential liability from such representations, warranties and indemnities because they relate to unknown conditions.

We indemnify our directors and certain employees as permitted by law. We have not recorded a liability associated with these indemnification arrangements as we historically have not incurred any losses associated with such indemnification obligations. Costs associated with such indemnification obligations may be mitigated by insurance coverage that we maintain; however, such insurance may not cover any of, or may cover only a portion of, the amounts we may be required to pay. In addition, such insurance coverage could change in the future.

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet financial arrangements or other contractually narrow or limited purposes at September 30, 2012. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

As of September 30, 2012, we had no off-balance sheet arrangements.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK. DERIVATIVE INSTRUMENTS**

We are exposed to fluctuations in interest rates. We actively monitor these fluctuations and use derivative instruments from time to time to manage the related risk. In accordance with our risk management strategy, we use derivative instruments only for the purpose of managing risk associated with an asset, liability, committed transaction, or probable forecasted transaction that is identified by management. Our use of derivative instruments may result in short-term gains or losses that may increase the volatility of our earnings.

Under FASB ASC Topic 815 Derivatives and Hedging the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income (outside earnings) and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings. The remaining gain or loss on the derivative instrument, if any, shall be recognized currently in earnings.

## **ITEM 4. CONTROLS AND PROCEDURES.**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon such evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2012.

There was no change in our internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.





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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

We and our subsidiaries, incident to our business activities, are parties to a number of legal proceedings, lawsuits, arbitration and other claims. Such matters are subject to many uncertainties and outcomes that are not predictable with assurance. We maintain insurance that may provide coverage for such matters. Consequently, we are unable to ascertain the ultimate aggregate amount of monetary liability or the financial impact with respect to these matters. We believe, at this time, that the final resolution of these matters, individually and in the aggregate, will not have a material adverse effect upon our consolidated financial position, results of operations or cash flows.

**ITEM 1A. RISK FACTORS.**

We have included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, a description of certain risks and uncertainties that could affect our business, future performance or financial condition (the Risk Factors ). The Risk Factors are hereby incorporated in Part II, Item 1A of this Form 10-Q. Investors should consider the Risk Factors prior to making an investment decision with respect to our stock.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None.

**ITEM 3. DEFAULT UPON SENIOR SECURITIES.**

None.

**ITEM 4. MINE SAFETY DISCLOSURES.**

None.

**ITEM 5. OTHER INFORMATION.**

None.

**ITEM 6. EXHIBITS.**

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, Salem Communications Corporation has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 9, 2012

SALEM COMMUNICATIONS CORPORATION

By: /s/ EDWARD G. ATSINGER III  
Edward G. Atsinger III  
Chief Executive Officer  
(Principal Executive Officer)

November 9, 2012

By: /s/ EVAN D. MASYR  
Evan D. Masyr  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

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<b>Exhibit Number</b>	<b>Exhibit Description</b>	<b>Form</b>	<b>File No.</b>	<b>Date of First Filing</b>	<b>Exhibit Number</b>	<b>Filed Herewith</b>
10.19.02	Amended and Restated Affiliate Line of Credit, dated as of September 12, 2012 between Salem Communications Corporation and Roland S. Hinz.	8-K	000-26497	09/17/12	99.1	
23.3	Consent of Bond & Pecaro					X
31.1	Certification of Edward G. Atsinger III Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.					X
31.2	Certification of Evan D. Masyr Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.					X
32.1	Certification of Edward G. Atsinger III Pursuant to 18 U.S.C. Section 1350.					X
32.2	Certification of Evan D. Masyr Pursuant to 18 U.S.C. Section 1350.					X
101	The following financial information from the Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Balance Sheets (ii) Condensed Consolidated Statements of Operations; (iii) the Condensed Consolidated Statements of Cash Flows; and (iv) the Notes to the Condensed Consolidated Financial Statements.					