GALLAGHER ARTHUR J & CO
Form 10-Q
May 07, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2018

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: 1-09761

ARTHUR J. GALLAGHER & CO.

(Exact name of registrant as specified in its charter)

Delaware	**36-2151613**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2850 W. Golf Road, Rolling Meadows, Illinois 60008-4050
(Address of principal executive offices) (Zip code)

(630) 773-3800
(Registrant s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 (§ 232.405 of this chapter) 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, a smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of outstanding shares of the registrant s common stock, $1.00 par value, as of April 30, 2018 was approximately 182,273,000.

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Information Concerning Forward-Looking Statements

This report contains certain statements related to future results, or states our intentions, beliefs and expectations or predictions for the future, which are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements relate to expectations or forecasts of future events. Such statements use words such as anticipate, believe, estimate, expect, contemplate, forecast, project, intend, potential, and other similar terms, and future or conditional tense verbs like could, may, might, see, should, would. You can also identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. For example, we may use forward-looking statements when addressing topics such as: market and industry conditions, including competitive and pricing trends; acquisition strategy; the expected impact of acquisitions and dispositions; the development and performance of our services and products; changes in the composition or level of our revenues or earnings; our cost structure and the outcome of cost-saving or restructuring initiatives; future capital expenditures; future debt levels and anticipated actions to be taken in connection with maturing debt; future debt to earnings ratios; the outcome of contingencies; dividend policy; pension obligations; cash flow and liquidity; capital structure and financial losses; future actions by regulators; the outcome of existing regulatory actions, investigations, reviews or litigation; the impact of changes in accounting rules; financial markets; interest rates; foreign exchange rates; matters relating to our operations; income taxes; expectations regarding our investments, including our clean energy investments; and integrating recent acquisitions. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from either historical or anticipated results depending on a variety of factors.

Potential factors that could impact results include:

- Failure to successfully and cost-effectively integrate recently acquired businesses and their operations or fully realize synergies from such acquisitions in the expected time frame;

- Volatility or declines in premiums or other adverse trends in the insurance industry;

- An economic downturn;

- Competitive pressures in each of our businesses;

- Risks that could negatively affect the success of our acquisition strategy, including continuing consolidation in our industry and growing interest in acquiring insurance brokers on the part of private equity firms, which could make it more difficult to identify targets and could make them more expensive, the risk that we may not receive timely regulatory approval of desired transactions, execution risks, integration risks, the risk of post-acquisition deterioration leading to intangible asset impairment charges, and the risk we could incur or assume unanticipated regulatory liabilities such as those relating to violations of anti-corruption and sanctions laws;

- Our failure to attract and retain experienced and qualified personnel;

Risks arising from our international operations, including the risks posed by political and economic uncertainty in certain countries (such as the risks posed by Brexit), risks related to maintaining regulatory and legal compliance across multiple jurisdictions (such as those relating to violations of anti-corruption, sanctions and privacy laws), and risks arising from the complexity of managing businesses across different time zones, geographies, cultures and legal regimes;

Risks particular to our risk management segment, including any slowing of the trend toward outsourcing claims administration, and of the concentration of large amounts of revenue with certain clients;

Under the new revenue recognition accounting standard, a higher level of uncertainty with respect to our revenue estimates for installments on agency bill, direct bill, contingent revenues, revenues in our employee benefit consulting and brokerage business and performance-based fees and audits within our risk management segment, which could cause us to reverse revenues recognized in prior periods or recognize additional revenues in future periods based on information we receive after such revenue is required to be recognized, including, for example, the actual growth or profitability of business placed in prior periods, the actual number of lives insured under employee benefit insurance policies, or the actual amounts billed under direct-bill arrangements;

Sustained increases in the cost of employee benefits;

Our failure to apply technology effectively in driving value for our clients through technology-based solutions, or failure to gain internal efficiencies and effective internal controls through the application of technology and related tools;

Our inability to recover successfully, including damage to our reputation and client relationships, should we experience a disaster, cybersecurity attack or other significant disruption to business continuity;

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Damage to our reputation;

Our failure to comply with regulatory requirements, including those related to governance and control requirements in particular jurisdictions, international sanctions, or a change in regulations or enforcement policies that adversely affects our operations (for example, relating to insurance broker compensation methods or the failure of state and local governments to follow through on agreed-upon income tax credits or other tax related incentives, relating to our corporate headquarters);

Violations or alleged violations of the U.S. Foreign Corrupt Practices Act (FCPA), the U.K. Bribery Act 2010 or other anti-corruption laws and Foreign Account Tax Compliance provisions of the Hiring Incentives to Restore Employment Act, (which we refer to as FATCA);

The outcome of any existing or future investigation, review, regulatory action or litigation;

Our failure to adapt our services to changes resulting from the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act and any changes in such laws brought about by the current administration;

Unfavorable determinations related to contingencies and legal proceedings;

Improper disclosure of confidential, personal or proprietary data;

Significant changes in foreign exchange rates;

Changes to our financial presentation from new accounting estimates and assumptions (including as a result of the new lease and revenue recognition standards);

Risks related to our clean energy investments, including the risk of intellectual property claims, utilities switching from coal to natural gas, environmental and product liability claims, and environmental compliance costs;

Disallowance of Internal Revenue Code of 1986, as amended, (which we refer to as IRC) Section 29 or IRC Section 45 tax credits for us or our partners;

The risk that our outstanding debt adversely affects our financial flexibility and restrictions and limitations in the agreements and instruments governing our debt;

The risk we may not be able to receive dividends or other distributions from subsidiaries;

The risk of share ownership dilution when we issue common stock as consideration for acquisitions and for other reasons; and

Volatility of the price of our common stock.

Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions, including the risk factors referred to above. Our future performance and actual results may differ materially from those expressed in forward-looking statements. Accordingly, you should not place undue reliance on forward-looking statements, which speak only as of, and are based on information available to us on, the date of the applicable document. Many of the factors that will determine these results are beyond our ability to control or predict. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section.

Forward-looking statements speak only as of the date that they are made, and we do not undertake any obligation to update any such statements or release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect new information, future or unexpected events or otherwise, except as required by applicable law or regulation.

A detailed discussion of the factors that could cause actual results to differ materially from our published expectations is contained under the heading Risk Factors in our filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and any other reports we file with the SEC in the future.

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Arthur J. Gallagher & Co.

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Part I - Financial Information

Item 1. Financial Statements (Unaudited)

Arthur J. Gallagher & Co.

Consolidated Statement of Earnings

(Unaudited - in millions, except per share data)

	Three-month period ended March 31, 2018	Three-month period ended March 31, 2017 As Restated*
Commissions	$ 839.4	$ 760.7
Fees	448.1	405.0
Supplemental revenues	52.0	47.3
Contingent revenues	34.9	35.0
Investment income	13.4	12.3
Gains on books of business sales	2.9	1.4
Revenues from clean coal activities	412.2	351.8
Other net losses		(0.2)
Revenues before reimbursements	1,802.9	1,613.3
Reimbursements	34.8	33.1
Total revenues	1,837.7	1,646.4
Compensation	775.8	711.8
Operating	216.1	199.5
Reimbursements	34.8	33.1
Cost of revenues from clean coal activities	431.2	366.9
Interest	31.3	29.9
Depreciation	30.6	29.5
Amortization	68.2	64.3
Change in estimated acquisition earnout payables	7.4	11.8
Total expenses	1,595.4	1,446.8
Earnings before income taxes	242.3	199.6
Benefit for income taxes	(43.7)	(42.4)
Net earnings	286.0	242.0
Net earnings attributable to noncontrolling interests	12.3	13.2

Net earnings attributable to controlling interests	$	273.7	$	228.8
Basic net earnings per share	$	1.51	$	1.28
Diluted net earnings per share		1.48		1.27
Dividends declared per common share		0.41		0.39

* See Note 3 - Revenues from Contracts with Customers for additional information about the restatements related to ASC 606.

See notes to consolidated financial statements.

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Arthur J. Gallagher & Co.

Consolidated Statement of Comprehensive Earnings

(Unaudited - in millions)

	Three-month period ended March 31,	
	2018	**2017 As Restated***
Net earnings	$ 286.0	$ 242.0
Change in pension liability, net of taxes	7.0	1.2
Foreign currency translation	62.3	55.9
Change in fair value of derivative investments, net of taxes	(6.8)	6.5
Comprehensive earnings	348.5	305.6
Comprehensive earnings attributable to noncontrolling interests	14.5	14.8
Comprehensive earnings attributable to controlling interests	$ 334.0	$ 290.8

* See Note 3 - Revenue from Contracts with Customers for additional information about the restatements related to ASC 606.

See notes to consolidated financial statements.

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Arthur J. Gallagher & Co.

Consolidated Balance Sheet

(Unaudited - in millions)

	March 31, 2018	December 31, 2017 As Restated*
Cash and cash equivalents	$ 697.9	$ 681.2
Restricted cash	1,410.8	1,623.8
Premiums and fees receivable	5,675.4	4,082.8
Other current assets	749.2	881.6
Total current assets	8,533.3	7,269.4
Fixed assets - net	424.2	412.2
Deferred income taxes	708.4	851.6
Other noncurrent assets	585.7	567.1
Goodwill	4,236.3	4,164.8
Amortizable intangible assets - net	1,639.6	1,644.6
Total assets	$ 16,127.5	$ 14,909.7
Premiums payable to underwriting enterprises	$ 6,071.3	$ 4,986.0
Accrued compensation and other current liabilities	799.7	947.8
Deferred revenue - current	390.4	355.3
Premium financing debt	121.0	151.1
Corporate related borrowings - current	360.0	290.0
Total current liabilities	7,742.4	6,730.2
Corporate related borrowings - noncurrent	2,792.1	2,691.9
Deferred revenue - noncurrent	74.8	75.3
Other noncurrent liabilities	933.7	1,112.6
Total liabilities	11,543.0	10,610.0
Stockholders equity:		
Common stock - issued and outstanding 182.1 shares in 2018 and 181.0 shares in 2017	182.1	181.0
Capital in excess of par value	3,405.3	3,388.2
Retained earnings	1,426.7	1,221.8
Accumulated other comprehensive loss	(499.5)	(555.4)

Stockholders equity attributable to controlling interests		4,514.6		4,235.6
Stockholders equity attributable to noncontrolling interests		69.9		64.1
Total stockholders equity		4,584.5		4,299.7
Total liabilities and stockholders equity	$	16,127.5	$	14,909.7

* See Note 3 - Revenue from Contracts with Customers for additional information about the restatements related to ASC 606.

See notes to consolidated financial statements.

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Arthur J. Gallagher & Co.

Consolidated Statement of Cash Flows

(Unaudited - in millions)

	Three-month period ended March 31, 2018	Three-month period ended March 31, 2017 As Restated*
Cash flows from operating activities:		
Net earnings	$ 286.0	$ 242.0
Adjustments to reconcile net earnings to net cash (used) provided by operating activities:		
Net gain on investments and other	(2.0)	(1.4)
Depreciation and amortization	98.8	93.8
Change in estimated acquisition earnout payables	7.4	11.8
Amortization of deferred compensation and restricted stock	9.9	6.2
Stock-based and other noncash compensation expense	4.8	4.1
Payments on acquisition earnouts in excess of original estimates	(9.0)	(9.1)
Effect of changes in foreign exchange rates	1.3	1.5
Net change in premiums receivable	(1,505.4)	(1,559.4)
Net change in deferred revenue	29.3	22.3
Net change in premiums payable to underwriting enterprises	979.4	1,119.0
Net change in other current assets	119.1	98.2
Net change in accrued compensation and other currrent liabilities	(165.4)	65.4
Net change in income taxes payable	16.2	(5.9)
Net change in deferred income taxes	(75.6)	(44.0)
Net change in other noncurrent assets and liabilities	(12.4)	(29.0)
Net cash (used) provided by operating activities	(217.6)	15.5
Cash flows from investing activities:		
Capital expenditures	(31.1)	(29.3)
Cash paid for acquisitions, net of cash and restricted cash acquired	(57.3)	(137.1)
Net proceeds from sales of operations/books of business	2.2	1.4
Net funding of investment transactions	(0.7)	(5.2)
Net cash used by investing activities	(86.9)	(170.2)
Cash flows from financing activities:		
Payments on acquisition earnouts	(9.4)	(10.6)
Proceeds from issuance of common stock	32.3	20.3
Repurchases of common stock	(11.3)	
Payments to noncontrolling interests	(8.6)	(7.6)
Dividends paid	(76.1)	(71.4)

Net borrowings on premium financing debt facility	(30.3)	(27.8)
Borrowings on line of credit facility	815.0	955.0
Repayments on line of credit facility	(645.0)	(838.0)
Settlements on terminated interest rate swaps	2.9	
Net cash provided by financing activities	69.5	19.9
Effect of changes in foreign exchange rates on cash and cash equivalents and restricted cash	38.7	19.2
Net decrease in cash, cash equivalents and restricted cash	(196.3)	(115.6)
Cash, cash equivalents and restricted cash at beginning of period	2,305.0	1,937.6
Cash, cash equivalents and restricted cash at end of period	$ 2,108.7	$ 1,822.0
Supplemental disclosures of cash flow information:		
Interest paid	$ 28.0	$ 30.1
Income taxes paid	11.6	12.2

* See Note 3 - Revenue from Contracts with Customers with Customers for additional information about the restatements related to ASC 606.

See notes to consolidated financial statements.

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Arthur J. Gallagher & Co.

Consolidated Statement of Stockholders Equity

(Unaudited - in millions)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Earnings (Loss)	Noncontrolling Interests	Total
	Shares	Amount					
Balance at December 31, 2017, as previously reported	181.0	$ 181.0	$ 3,388.2	$ 1,095.9	$ (559.9)	$ 59.7	$ 4,164.9
Adoption of ASC Topic 606				125.9	4.5	4.4	134.8
Balance at December 31, 2017, as restated	181.0	181.0	3,388.2	1,221.8	(555.4)	64.1	4,299.7
Reclassification of the income tax effects within accumulated other comprehensive loss related to the Tax Act				6.6	(6.6)		
Net earnings				273.7		12.3	286.0
Dividends paid to noncontrolling interests						(8.7)	(8.7)
Net change in pension asset/liability, net of taxes of ($4.6) million					7.0		7.0
Foreign currency translation					62.3	2.2	64.5
Change in fair value of derivative instruments, net of taxes of ($1.2) million					(6.8)		(6.8)
Compensation expense related to stock option plan grants			4.8				4.8
Common stock issued in:							
Three purchase transactions	0.1	0.1	6.4				6.5
Stock option plans	0.8	0.8	27.4				28.2
Employee stock purchase plan	0.1	0.1	4.0				4.1
Deferred compensation and restricted stock	0.2	0.2	(14.3)				(14.1)
Common stock repurchases	(0.1)	(0.1)	(11.2)				(11.3)
Cash dividends declared on common stock				(75.4)			(75.4)
Balance at March 31, 2018	182.1	$ 182.1	$ 3,405.3	$ 1,426.7	$ (499.5)	$ 69.9	$ 4,584.5

See notes to consolidated financial statements.

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Notes to March 31, 2018 Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Terms Used in Notes to Consolidated Financial Statements

ASC - Accounting Standards Codification.

ASC Topic 606 - ASU No. 2014-09, Revenue from Contracts with Customers.

ASU - Accounting Standards Update.

FASB - The Financial Accounting Standards Board.

GAAP - U.S. generally accepted accounting principles.

IRC - Internal Revenue Code.

IRS - Internal Revenue Service.

Underwriting enterprises - Insurance companies, reinsurance companies and various other forms of risk-taking entities, including intermediaries of underwriting enterprises.

VIE - Variable interest entity.

Nature of Operations and Basis of Presentation

Arthur J. Gallagher & Co. and its subsidiaries, collectively referred to herein as we, our, us or the company, provide insurance brokerage, consulting and third party claims settlement and administration services to both domestic and international entities through three reportable operating segments. Our brokers, agents and administrators act as intermediaries between underwriting enterprises and our clients.

Our brokerage segment operations provide brokerage and consulting services to companies and entities of all types, including commercial, not-for-profit, and public entities, and, to a lesser extent, individuals, in the areas of insurance placement, risk of loss management, and management of employer sponsored benefit programs. Our risk management segment operations provide contract claim settlement, claim administration, loss control services and risk management consulting for commercial, not-for-profit, captive and public entities, and various other organizations that choose to self-insure property/casualty coverages or choose to use a third-party claims management organization rather than the claim services provided by underwriting enterprises. The corporate segment reports the financial information related to our debt, clean energy investments, external acquisition-related expenses and other corporate costs. Clean energy investments consist of our investments in limited liability companies that own 34 commercial clean coal production facilities producing refined coal using Chem-Mod LLC s proprietary technologies. We believe these operations produce refined coal that qualifies for tax credits under IRC Section 45.

We do not assume underwriting risk on a net basis, other than with respect to de minimis amounts necessary to provide minimum or regulatory capital to organize captives, pools, specialized underwriters or risk-retention groups. Rather, capital necessary for events of loss coverages is provided by underwriting enterprises.

Investment income and other revenues are generated from our premium financing operations and our investment portfolio, which includes our invested cash and restricted cash we hold on behalf of our clients, as well as clean energy investments.

We are headquartered in Rolling Meadows, Illinois, have operations in 33 countries and offer client-service capabilities in more than 150 countries globally through a network of correspondent insurance brokers and consultants.

We have prepared the accompanying unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been omitted pursuant to such rules and regulations. The unaudited consolidated financial statements included herein are, in the opinion of management, prepared on a basis consistent with our audited consolidated financial statements for the year ended December 31, 2017, except as disclosed in Note 2, and include all normal recurring adjustments necessary for a fair presentation of the information set forth. The quarterly results of operations are not necessarily indicative of the results of operations to be reported for subsequent quarters or the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017. In the preparation of our unaudited consolidated financial statements as of March 31, 2018, management evaluated all material subsequent events or transactions that occurred after the balance sheet date through the date on which the financial statements were issued, for potential recognition or disclosure therein.

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Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These accounting principles require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses, and the disclosure of contingent assets and liabilities at the date of our consolidated financial statements. We are also required to make certain judgments and estimates that affect the disclosed and recorded amounts of revenues and expenses related to the impact of the adoption of and accounting under ASC Topic 606. We periodically evaluate our estimates and assumptions, including those relating to the valuation of goodwill and other intangible assets, investments (including our IRC Section 45 investments), income taxes, revenue recognition, deferred costs, stock-based compensation, claims handling obligations, retirement plans, litigation and contingencies. We base our estimates on historical experience and various assumptions that we believe to be reasonable based on specific circumstances. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Revenue Recognition

Our revenues are derived from commissions and fees as primarily specified in a written contract, or unwritten business understanding, with our clients or underwriting enterprises. We also recognize investment income over time from our invested assets and invested assets we hold on behalf of our clients or underwriting enterprises.

BROKERAGE SEGMENT

Our brokerage segment generates revenues by:

(i) Identifying, negotiating and placing all forms of insurance or reinsurance coverage, as well as providing risk-shifting, risk-sharing and risk-mitigation consulting services, principally related to property/casualty, life, health, welfare and disability insurance. We also provide these services through, or in conjunction with, other unrelated agents and brokers, consultants and management advisors.

(ii) Acting as an agent or broker for multiple underwriting enterprises by providing services such as sales, marketing, selecting, negotiating, underwriting, servicing and placing insurance coverage on their behalf.

(iii) Providing consulting services related to health and welfare benefits, voluntary benefits, executive benefits, compensation, retirement planning, institutional investment and fiduciary, actuarial, compliance, private insurance exchange, human resource technology, communications and benefits administration.

(iv) Providing management and administrative services to captives, pools, risk-retention groups, healthcare exchanges, small underwriting enterprises, such as accounting, claims and loss processing assistance, feasibility studies, actuarial studies, data analytics and other administrative services.

The majority of our brokerage contracts and service understandings are for a period of one year or less.

Commissions and fees

The primary source of revenues for our brokerage services are commissions from underwriting enterprises, based on a percentage of premiums paid by our clients, or fees received from clients based on an agreed level of service usually in lieu of commissions.

Commissions are fixed at the contract effective date and generally are based on a percentage of premiums for insurance coverage or employee head count for employer sponsored benefit plans. Commissions depend upon a large number of factors, including the type of risk being placed, the particular underwriting enterprise s demand, the expected loss experience of the particular risk of coverage, and historical benchmarks surrounding the level of effort necessary for us to place and service the insurance contract. Rather than being tied to the amount of premiums, fees are most often based on an expected level of effort to provide our services.

Whether we are paid a commission or a fee, the vast majority of our services are associated with the placement of an insurance (or insurance-like) contract. Accordingly, we recognize approximately 70% of our commission and fee revenues on the effective date of the underlying insurance contract. The amount of revenue we recognize is based on our costs to provide our services up and through that effective date, including an appropriate estimate of our profit margin on a portfolio basis (a practical expedient as defined in ASC Topic 606). Based on the proportion of additional services we provide in each period after the effective date of the insurance contract, including an appropriate estimate of our profit margin, we recognize approximately 20% of our commission and fee revenues in the first three months, and the remaining 10% thereafter. These periods may be different than the underlying premium payment patterns of the insurance contracts, but the vast majority of our services are fully provided within one year of the insurance contract effective date.

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For consulting and advisory services, we recognize our revenue in the period in which we provide the service or advice. For management and administrative services, our revenue is recognized ratably over the contract period consistent with the performance of our obligations, mostly over an annual term.

Supplemental revenues

Certain underwriting enterprises may pay us additional revenues for the volume of premium placed with them and for insights into our sales pipeline, our sales capabilities or our risk selection knowledge. These amounts are in excess of the commission and fee revenues discussed above, and not all business we place with underwriting enterprises is eligible for supplemental revenues. Unlike contingent revenues, discussed below, these revenues are a fixed amount or fixed percentage of premium of the underlying eligible insurance contracts. For supplemental revenue contracts based on a fixed percentage of premium, our obligation to the underwriting enterprise is substantially completed upon the effective date of the underlying insurance contract and revenue is fully earned at that time. For supplemental revenue contracts based on a fixed amount, revenue is recognized ratably over the contract period consistent with the performance of our obligations, almost always over an annual term. We receive these revenues on a quarterly or annual basis.

Contingent revenues

Certain underwriting enterprises may pay us additional revenues for our sales capabilities, our risk selection knowledge, or our administrative efficiencies. These amounts are in excess of the commission or fee revenues discussed above, and not all business we place with participating underwriting enterprises is eligible for contingent revenues. Unlike supplemental revenues, also discussed above, these revenues are variable, generally based on growth, the loss experience of the underlying insurance contracts, and/or our efficiency in processing the business. We generally operate under calendar year contracts, but we do not receive these revenues from the underwriting enterprises until the following calendar year, generally in the first and second quarters, after verification of the performance indicators outlined in the contracts. Accordingly, during each reporting period, we must make our best estimate of amounts we have earned using historical averages and other factors to project such revenues. We base our estimates each period on a contract-by-contract basis where available. In certain cases, it is impractical to assess a very large number of smaller contingent revenue contracts, so we use a historical portfolio estimate in aggregate (a practical expedient as defined in ASC Topic 606). Because our expectation of the ultimate contingent revenue amounts to be earned can vary from period to period, especially in contracts sensitive to loss ratios, our estimates might change significantly from quarter to quarter. For example, in circumstances where our revenues are dependent on a full calendar year loss ratio, adverse loss experience in the fourth quarter could not only negate revenue earnings in the fourth quarter, but also trigger the need to reverse revenues previously recognized during the prior quarters. Variable consideration is recognized when we conclude, based on all the facts and information available at the reporting date, that is it probable that a significant revenue reversal will not occur in future periods.

Sub-brokerage costs

Sub-brokerage costs are excluded from our gross revenues in our determination of total revenues. Sub-brokerage cost represents commissions paid to sub-brokers related to the placement of certain business by our brokerage segment operations. We recognize this contra revenue in the same manner as the commission revenue it relates to.

RISK MANAGEMENT SEGMENT

Revenues for our risk management segment are comprised of fees generally negotiated (i) on a per-claim basis, (ii) on a cost-plus basis, or (iii) as performance-based fees. We also provide risk management consulting services that are recognized as the services are delivered.

Per-claim fees

Where we operate under a contract with our fee established on a per claim basis, our obligation is to process claims for a term specified within the contract. Because it is impractical to recognize our revenues on an individual claim by claim basis, we recognize revenue plus an appropriate estimate of our profit margin on a portfolio basis by grouping claims with similar characteristics (a practical expedient as defined in ASC Topic 606). We apply actuarially-determined, historical-based patterns to determine our future service obligations, without applying a present value discount.

Cost-plus fees

Where we provide services and generate revenues on a cost-plus basis, we recognize revenue over the contract period consistent with the performance of our obligations.

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Performance-based fees

Certain clients pay us additional fee revenues for our efficiency in managing claims or on the basis of claim outcome effectiveness. These amounts are in excess of the fee revenues discussed above. These revenues are variable, generally based on performance metrics set forth in the underlying contracts. We generally operate under multi-year contracts with fiscal year measurement periods. We do not receive these fees, if earned, until the following year after verification of the performance metrics outlined in the contracts. Each period we base our estimates on a contract-by-contract basis. We must make our best estimate of amounts we have earned using historical averages and other factors to project such revenues. Variable consideration is recognized when we conclude that is it probable that a significant revenue reversal will not occur in future periods.

Reimbursements

Reimbursement represent amounts received from clients reimbursing us for certain third-party costs associated with providing our claims management services. In certain service partner relationships, we are considered a principal because we direct the third party, control the specified service and combine the services provided into an integrated solution. Given this principal relationship, we are required to recognize revenue gross and service partner vendor fees in the operating expense in our consolidated statement of earnings.

Deferred Costs

We incur costs to provide brokerage and risk management services. Those costs are either (i) costs to obtain a contract or (ii) costs to fulfill such contract, or (iii) all other costs.

(i) Costs to obtain - we incur costs to obtain a contract with a client. Those costs would not have been incurred if the contract had not been obtained. Almost all of our costs to obtain are incurred prior to, or on, the effective date of the contract and consist primarily of incentive compensation we pay to our production employees. Our costs to obtain are expensed as incurred as described in Note 3 to these unaudited consolidated financial statements.

(ii) Costs to fulfill - we incur costs to fulfill a contract (or anticipated contract) with a client. Those costs are incurred prior to the effective date of the contract and relate to fulfilling our primary placement obligations to our clients. Our costs to fulfil prior to the effective date are capitalized and amortized on the effective date. These fulfilment activities include collecting underwriting information from our client, assessing their insurance needs and negotiating their placement with one or more underwriting enterprises. The majority of costs that we incur relate to compensation and benefits of our client service employees. Costs incurred during preplacement activities are expected to be recovered in the future. If the capitalized costs are no longer deemed to be recoverable, then they would be expensed.

(iii) Other costs that are not costs to obtain or fulfill are expensed as incurred. Examples include other operating costs such as rent, utilities, management costs, overhead costs, legal and other professional fees, technology costs, insurance related costs, communication and advertising, and travel and entertainment. Depreciation, amortization and change in estimated acquisition earnout payable are expensed as incurred.

2. Effect of New Accounting Pronouncements

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, ASC Topic 606, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principal of the new accounting guidance is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. We adopted ASC Topic 606 as of January 1, 2018, using the full retrospective method to restate each prior reporting period presented. The cumulative effect of the adoption was recognized as an increase to retained earnings of $125.3 million on January 1, 2016. The impact of the adoption of the new guidance resulted in changes to our accounting policies for revenue recognition, trade and other receivables, and deferred revenues as detailed in Note 3 to these unaudited consolidated financial statements. In implementing the full retrospective method of adoption, we applied the practical expedient as defined in ASC Topic 606 of using the benefit of hindsight to recognize contingent revenues (i.e., variable consideration) in 2017 and 2016.

Hedge Accounting

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (ASC Topic 815): Targeted Improvements to Accounting for Hedging Activities. The new guidance amends the hedge accounting model in the current guidance to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The new guidance requires revised tabular disclosures that focus on the effect of hedge accounting by income statement line and the disclosure of the cumulative basis adjustments to the hedged assets and liabilities in fair value hedges. Certain additional disclosures are also required for hedge relationships designated under the last-of-layer method. The current guidance that requires entities to disclose hedge ineffectiveness has been eliminated because this amount will no longer be separately measured. Under the new guidance, entities will apply the amendments to cash flow and net investment hedge relationships that exist on the date of adoption using a modified retrospective approach (i.e., with a cumulative effect adjustment recorded to the opening balance of retained earnings as of the initial application date). The new guidance also provides transition relief to make it easier for entities to apply certain amendments to existing hedges (including fair value hedges) where the hedge documentation needs to be modified. The presentation and disclosure requirements will be applied prospectively. The new guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those periods. Early adoption is permitted in any interim period or annual year before the effective date. If the guidance is early adopted in an interim period, any adjustments would be reflected as of the beginning of the fiscal year that includes that interim period. We are currently assessing the impact that adopting this new guidance will have on our consolidated financial statements.

Presentation of Net Periodic Pension and Postretirement Benefit Cost

In March 2017, the FASB issued ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The new guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. An entity will apply the new guidance retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the consolidated statement of earnings. The new guidance allows a practical expedient that permits an employer to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. The new guidance was effective in the first quarter of 2018, which we adopted effective January 1, 2018. The adoption of this guidance had no impact on our consolidated net earnings. Due to the adoption of this new guidance, the presentation in our consolidated statement of earnings was changed in 2018 such that the other components of net periodic pension costs related to our defined benefit plan were recorded in operating expense instead of compensation expense as was done in prior years. Prior years were not restated for this change as the impact of this change was not material to our consolidated statement of earnings. See Note 12 to our most recent Annual Report on Form 10-K as of December 31, 2017 for additional discussion of these costs.

Business Combinations

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The new guidance clarifies the definition of a business with the objective of adding information to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. The new guidance was effective for annual periods beginning after December 15, 2017, including interim periods within those periods, which we adopted effective January 1, 2018. The adoption of this new guidance did not have a material impact on our consolidated financial statements.

Intangibles - Goodwill and Other

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The new guidance eliminates Step 2 of the goodwill impairment test. Instead, the updated guidance requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of the reporting unit to its carrying value, and recognizing a non-cash impairment charge for the amount by which the carrying value exceeds the reporting unit s fair value with the loss not exceeding the total amount of goodwill allocated to that reporting unit. The new guidance is effective beginning January 1, 2020, with early adoption permitted, and will be applied on a prospective basis. The new guidance currently has no impact on our consolidated financial statements; however, we will evaluate the impact of this updated guidance on future annual or interim goodwill impairment tests performed.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under this new accounting guidance, an entity is required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. This new guidance offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. This new guidance is effective for first quarter 2019, and requires a modified retrospective adoption, with early adoption permitted. Under the modified retrospective approach, lessees are required to recognize and measure leases at the beginning of the earliest period presented. In addition, the modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset.

While we are continuing to assess all potential impacts of the new guidance, we anticipate this guidance will have an impact on our consolidated financial statements. We currently believe the most significant impact relates to our real estate operating leases and the related recognition of right-of-use assets and lease liabilities in both noncurrent assets and noncurrent liabilities in our consolidated balance sheet. See Note 14 to these unaudited consolidated financial statements for details on our current lease arrangements.

Income Taxes

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This new accounting guidance allows entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Current guidance does not allow recognition until the asset has been sold to an outside party. This new guidance was effective beginning January 1, 2018 and was to be applied on a modified retrospective basis. We adopted this new guidance effective January 1, 2018 and it did not have a material impact on our consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, Reclassification of tax effects stranded in AOCI. This new guidance gives entities the option to reclassify to retained earnings stranded tax effects related to the change in federal tax rate for all items accounted for in other comprehensive earnings (OCI). These entities can also elect to reclassify other stranded tax effects that relate to the Tax Cuts and Jobs Act (which we refer to as the Tax Act) but do not directly relate to the change in the federal rate (e.g., state taxes, changing from a worldwide tax system to a territorial system). Tax effects that are stranded in OCI for other reasons (e.g., prior changes in tax law, a change in valuation allowance) cannot be reclassified. All entities are required to make new disclosures, regardless of whether they elect to reclassify stranded amounts. Entities are required to disclose whether or not they elected to reclassify the tax effects related to the Tax Act as well as their policy for releasing income tax effects from accumulated OCI. Under ASC 740-10-45-15, the effects of changes in tax rates and laws on deferred tax balances are recorded as a component of tax expense related to continuing operations for the period in which the law was enacted, even if the assets and liabilities related to items of accumulated OCI. The enactment of the Tax Act on December 22, 2017 resulted in stakeholder concerns about this accounting treatment. The new guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted for reporting periods, including interim periods, for which financial statements have not yet been issued or made available for issuance. An entity will be able to choose whether to apply the guidance retrospectively to each period in which the effect of the Tax Act is recognized or to apply the guidance in the period of adoption. We adopted this new guidance effective January 1, 2018, which resulted in a $6.6 million increase in retained earnings and a corresponding decrease in accumulated other comprehensive earnings (loss). This reclass relates to the income tax effects of lowering the corporate income tax rate from 35.0% to 21.0% on deferred income taxes established on pension plan liabilities and the fair value of derivative instruments.

In March 2018, the FASB issued ASU No. 2018-05 Income Taxes (Topic 740): Amendment to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. This new accounting guidance codifies guidance pursuant to SEC

Staff Accounting Bulletin No. 118 (which we refer to as SAB 118), which was issued in connection with the Tax Act. The guidance allows companies to use provisional estimates to record the effects of the Tax Act and also provides a measurement period (not to exceed one year from the date of enactment) to complete the accounting for the impacts of the Tax Act. We adopted this guidance when it was initially issued as SAB 118. We are still completing our accounting for the tax effects of the Tax Act because all the necessary information is not currently available, prepared or analyzed. As such, we have made reasonable estimates of the effects of the Tax Act on our financial results. As we complete our analysis of the accounting for the tax effects of enactment of the Tax Act, we may record additional provisional amounts or adjustments to provisional amounts as discrete items in future periods.

Restricted Cash

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. This new accounting guidance addresses the classification and presentation of changes in restricted cash on the statement of cash flows under Topic 230, Statement of Cash Flows. This guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted for all entities. The adoption of this new guidance changed the presentation in our consolidated statement of cash flows as we now show the changes in the total of cash, cash equivalents and restricted cash in the statement of cash flows. Previously, the net change in restricted cash was reported as an operating activity and cash paid for acquisitions, net of cash was not presented net of restricted cash. In our 2017 consolidated statement of cash flows, the adoption of ASU 2016-18 resulted in a decrease to net cash provided by operating activities of $154.2 million and a decrease to cash paid for acquisitions, net of cash and restricted cash of $7.9 million. These changes resulted in a change of $12.2 million to the effect of changes in foreign exchange rates on cash, cash equivalents and restricted cash.

The following is a reconciliation of our March 31 cash, cash equivalents and restricted cash balances as presented in the consolidated statement of cash flows for the three-month periods ended March 31, 2018 and 2017 (in millions):

	March 31,	
	2018	**2017**
Cash and cash equivalents	$ 697.9	$ 564.0
Restricted cash	1,410.8	1,258.0
Total cash, cash equivalents and restricted cash	$ 2,108.7	$ 1,822.0

3. Revenue from Contracts with Customers

New Accounting Statement Impact on Consolidated Financial Statements

As a result of adopting a new revenue recognition accounting statement, we restated our consolidated financial statements from amounts previously reported. The primary impacts of the adoption of the new revenue recognition guidance to our segments are detailed as follows.

Brokerage segment

Revenue - We previously recognized revenue for certain of our brokerage activities, such as installments on agency bill, direct bill and contingent revenue, over a period of time either due to the transfer of value to our clients or as the remuneration became determinable. Under the new guidance, these revenues are now substantially recognized at a point in time on the effective date of the associated policies when control of the policy transfers to the client. On the other hand, under the new guidance we are now required to defer certain revenues to reflect delivery of services over the contract period. As a result, revenue from certain arrangements are now recognized in earlier periods under the new guidance in comparison to our previous accounting policies, and other revenues are recognized in later periods. The net effect of all of these changes on the timing and amount of revenue recognized is a net increase in revenue recognized for our annual reporting periods with a shift in the timing of revenue recognized in the interim periods to the first quarter from the other three quarters.

The primary reason for the increase in the amount of revenue recognized relates to our employee benefit brokerage business. Historically we recognized this revenue throughout the contract period as underlying client exposure units became certain. Under the new guidance, the full year revenue under each of these contracts is now estimated at the effective date of the underlying policies resulting in acceleration of revenue recognized, with a reassessment at each reporting date. This also causes a shift in the timing of revenue recognized in the interim periods as a majority of these annual contracts incept in the first quarter. Partially offsetting this interim impact is the recognition of contingent revenues related to our brokerage business as these revenues are now estimated and accrued throughout the year as the underlying business is placed with the underwriting enterprises rather than our historical practice of recognizing the majority of these revenues in the first quarter, because this is typically when we receive cash or the related policy detail or other carrier specific information from the underwriting enterprise.

Expense - The assets recognized for the costs to obtain and/or fulfill a contract are amortized on a systematic basis that is consistent with the transfer of the services to which the asset relates. For the majority of our contracts, the renewal period is one year or less and renewal costs are commensurate with the initial contract. As a result, we have applied a practical expedient and recognize the costs of obtaining a contract as an expense when incurred. The net impact of deferring and amortizing the costs to fulfill a contract are not material on an annual basis, but have an impact on the timing of expenses recognized in the interim periods. Previously those costs were expensed as incurred.

Risk management segment

Revenue - Under the new guidance, when we have the obligation to adjust claims until closure and are compensated on a per claim basis, we record the full amount of the claim revenue upon notification of the claim and defer certain revenues to reflect delivery of services over the claim handling period. When our obligation is to provide claims services throughout a contract period, we recognize revenue ratably across that contract period. As such, the net impact of the new guidance requires greater initial revenue deferral and recognition over a longer period of time than under our previous accounting policies.

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Expense - The assets recognized for the costs to obtain and/or to fulfill a contract are amortized on a systematic basis that is consistent with the transfer of the services to which the asset relates. We do not have material costs to obtain or fulfill. The net impact of deferring and amortizing these costs to obtain or to fulfill are not material on our annual or interim reporting periods.

Corporate segment

The timing related to recognition of revenue in our corporate segment remains substantially unchanged. While there is no material impact on our annual after tax earnings, there is a material change to our after tax earnings in the interim quarterly periods, as income tax credits are recognized based on our quarterly consolidated pretax earnings patterns.

Impact on 2017 Consolidated Financial Statements

The consolidated statement of earnings line items, which reflect the adoption of the new revenue recognition guidance, are as follows (in millions, except per share data):

	Three-month period ended March 31, 2017		
	As Previously Reported	Impact of Adoption of ASC 606	As Restated for Adoption of ASC 606
Commissions	$ 590.5	$ 170.2	$ 760.7
Fees	370.5	34.5	405.0
Supplemental revenues	34.5	12.8	47.3
Contingent revenues	53.4	(18.4)	35.0
Investment income	10.8	1.5	12.3
Gains on books of business sales	1.4		1.4
Revenues from clean coal activities	351.8		351.8
Other net losses	(0.2)		(0.2)
Revenues before reimbursements	1,412.7	200.6	1,613.3
Reimbursements		33.1	33.1
Total revenues	1,412.7	233.7	1,646.4
Compensation	657.6	54.2	711.8
Operating	200.4	(0.9)	199.5
Reimbursements		33.1	33.1
Cost of revenues from clean coal activities	366.9		366.9
Interest	29.9		29.9
Depreciation	29.5		29.5
Amortization	64.3		64.3
Change in estimated acquisition earnout payables	11.8		11.8
Total expenses	1,360.4	86.4	1,446.8
Earnings before income taxes	52.3	147.3	199.6

Benefit for income taxes		(15.5)		(26.9)		(42.4)
Net earnings		67.8		174.2		242.0
Net earnings attributable to noncontrolling interests		12.1		1.1		13.2
Net earnings attributable to controlling interests	$	55.7	$	173.1	$	228.8
Basic net earnings per share	$	0.31	$	0.97	$	1.28
Diluted net earnings per share		0.31		0.96		1.27
Dividends declared per common share		0.39				0.39

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Select consolidated statement of comprehensive earnings line items, which reflect the adoption of the new revenue recognition guidance, are as follows (in millions):

	Three-month period ended March 31, 2017		
	As Previously Reported	Impact of Adoption of ASC 606	As Restated for Adoption of ASC 606
Net earnings	$ 67.8	$ 174.2	$ 242.0
Change in pension liability, net of taxes	1.2		1.2
Foreign currency translation	58.4	(2.5)	55.9
Change in fair value of derivative instruments, net of taxes	6.5		6.5
Comprehensive earnings	133.9	171.7	305.6
Comprehensive earnings attributable to noncontrolling interests	13.7	1.1	14.8
Comprehensive earnings attributable to controlling interests	$ 120.2	$ 170.6	$ 290.8

Select balance sheet line items, which reflect the adoption of the new revenue recognition guidance are as follows (in millions):

	December 31, 2017		
	As Previously Reported	Impact of Adoption of ASC 606	As Restated for Adoption of ASC 606
Assets			
Premium and fees receivables	$ 2,157.2	$ 1,925.6	$ 4,082.8
Other current assets	708.4	173.2	881.6
Deferred income taxes	905.1	(53.5)	851.6
Other noncurrent assets	567.0	0.1	567.1
Goodwill	4,197.9	(33.1)	4,164.8
Liabilities			
Premiums payable to underwriting enterprises	3,475.9	1,510.1	4,986.0
Accrued compensation and other current liabilities	864.1	83.7	947.8
Deferred revenue - current/unearned fees	74.8	280.5	355.3
Other current liabilities	56.4	(56.4)	
Deferred revenue - noncurrent		75.3	75.3
Other noncurrent liabilities	1,128.3	(15.7)	1,112.6
Stockholders equity			
Retained earnings	1,095.9	125.9	1,221.8
Accumulated other comprehensive loss	(559.9)	4.5	(555.4)
Stockholders equity attributable to controlling interests	4,105.2	130.4	4,235.6
Stockholders equity attributable to noncontrolling interests	59.7	4.4	64.1

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Select consolidated statement of cash flows line items, which reflect the adoption of the new revenue recognition guidance are as follows (in millions):

	Three-month period ended March 31, 2017		
	As Previously Reported	Impact of Adoption of ASC 606	As Restated for Adoption of ASC 606
Cash flows from operating activities			
Net earnings	$ 67.8	$ 174.2	$ 242.0
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Net change in premiums receivable	(206.3)	(1,353.1)	(1,559.4)
Net change in deferred revenue		22.3	22.3
Net change in premiums payable to underwriting enterprises	(30.1)	1,149.1	1,119.0
Net change in other current assets	56.2	42.0	98.2
Net change in accrued compensation and other current liabilities	43.1	22.3	65.4
Net change in deferred income taxes	(17.2)	(26.8)	(44.0)
Net change in other noncurrent assets and liabilities	(28.0)	(1.0)	(29.0)

Select statement of stockholders equity items, which reflect the adoption of the new revenue recognition guidance are as follows (in millions):

	Retained Earnings	Accumulated Other Comprehensive Earnings (Loss)	Stockholders Equity Attributable to Noncontrolling Interests	Total Stockholders Equity
Balance at December 31, 2017, as reported	$ 1,095.9	$ (559.9)	$ 59.7	$ 4,164.9
Cumulative-effect adjustment due to ASC Topic 606 as of December 31, 2017	125.9	4.5	4.4	134.8
Balance at December 31, 2017, as restated	$ 1,221.8	$ (555.4)	$ 64.1	$ 4,299.7

Contract Assets and Liabilities/Contract Balances

Information about unbilled receivables, contract assets and contract liabilities from contracts with customers is as follows (in millions):

	March 31, 2018	December 31, 2017, As Restated
Unbilled receivables	$ 682.1	$ 415.2

Deferred contract costs	48.9	83.3
Deferred revenue	465.2	430.6

The unbilled receivables primarily relate to our rights to consideration for work completed but not billed at the reporting date. These are transferred to the receivables when the client is billed. The deferred contract costs represent the costs we incur to fulfill a new or renewal contract with our clients prior to the effective date of the contract. These costs are expensed on the contract effective date. The deferred revenue represents the remaining performance obligations under our contracts.

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Significant changes in the deferred revenue balances during the period are as follows (in millions):

	Brokerage	Risk Management	Total
Deferred revenue at December 31, 2017	$ 258.7	$ 171.9	$ 430.6
Incremental deferred revenue	144.6	37.9	182.5
Revenue recognized during the three-month period ended March 31, 2018 included in deferred revenue at December 31, 2017	(115.9)	(32.7)	(148.6)
Deferred revenue recognized from business acquisitions	0.7		0.7
Deferred revenue at March 31, 2018	$ 288.1	$ 177.1	$ 465.2

Remaining Performance Obligations

Remaining performance obligations represent the portion of the contract price for which work has not been performed. As of March 31, 2018, the aggregate amount of the contract price allocated to remaining performance obligations was $465.2 million. The estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period is as follows (in millions):

	Brokerage	Risk Management	Total
2018 (remaining nine months)	$ 244.0	$ 85.3	$ 329.3
2019	31.7	49.1	80.8
2020	9.0	21.3	30.3
2021	2.8	8.9	11.7
2022	0.4	4.7	5.1
Thereafter	0.2	7.8	8.0
Total	$ 288.1	$ 177.1	$ 465.2

Deferred Contract Costs

We capitalize costs incurred to fulfill contracts as deferred contract costs on our consolidated balance sheets. Deferred contract costs were $48.9 million and $83.3 million as of March 31, 2018 and December 31, 2017, respectively. Capitalized fulfillment costs are amortized on the contract effective date. The amount of amortization of the deferred contract costs was $100.4 million and $91.2 million for the three-month periods ended March 31, 2018, and 2017, respectively.

As part of our adoption of the new revenue recognition guidance, we have elected to apply the practical expedient to recognize the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that we otherwise would have recognized is one year or less for our brokerage segment. These costs are included in compensation and operating expenses in our consolidated statement of earnings.

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4. Business Combinations

During the three-month period ended March 31, 2018, we acquired substantially all of the net assets of the following firms in exchange for our common stock and/or cash. These acquisitions have been accounted for using the acquisition method for recording business combinations (in millions, except share data):

Name and Effective Date of Acquisition	Common Shares Issued (000s)	Common Share Value	Cash Paid	Accrued Liability	Escrow Deposited	Recorded Earnout Payable	Total Recorded Purchase Price	Maximum Potential Earnout Payable
Market Financial Group, Ltd and Austin Consulting Group Inc. (MFG) January 1, 2018	53	$ 3.7	$ 33.9	$	$ 4.2	$ 4.0	$ 45.8	$ 7.0
McGregor & Associates (M&A) March 1, 2018			13.5		2.5	5.1	21.1	12.0
Five other acquisitions completed in 2018	7		14.9		1.9	4.5	21.3	12.1
	60	$ 3.7	$ 62.3	$	$ 8.6	$ 13.6	$ 88.2	$ 31.1

Common shares issued in connection with acquisitions are valued at closing market prices as of the effective date of the applicable acquisition. We record escrow deposits that are returned to us as a result of adjustments to net assets acquired as reductions of goodwill when the escrows are settled. The maximum potential earnout payables disclosed in the foregoing table represent the maximum amount of additional consideration that could be paid pursuant to the terms of the purchase agreement for the applicable acquisition. The amounts recorded as earnout payables, which are primarily based upon the estimated future operating results of the acquired entities over a two- to three-year period subsequent to the acquisition date, are measured at fair value as of the acquisition date and are included on that basis in the recorded purchase price consideration in the foregoing table. We will record subsequent changes in these estimated earnout obligations, including the accretion of discount, in our consolidated statement of earnings when incurred.

The fair value of these earnout obligations is based on the present value of the expected future payments to be made to the sellers of the acquired entities in accordance with the provisions outlined in the respective purchase agreements, which is a Level 3 fair value measurement. In determining fair value, we estimated the acquired entity s future performance using financial projections developed by management for the acquired entity and market participant assumptions that were derived for revenue growth and/or profitability. Revenue growth rates generally ranged from 5.0% to 15.0% for our 2018 acquisitions. We estimated future payments using the earnout formula and performance targets specified in each purchase agreement and these financial projections. We then discounted these payments to present value using a risk-adjusted rate that takes into consideration market-based rates of return that reflect the ability of the acquired entity to achieve the targets. These discount rates generally ranged from 8.0% to 9.5% for all of our 2018 acquisitions. Changes in financial projections, market participant assumptions for revenue growth and/or profitability, or the risk-adjusted discount rate, would result in a change in the fair value of recorded earnout obligations.

During the three-month periods ended March 31, 2018 and 2017, we recognized $5.1 million and $5.1 million, respectively, of expense in our consolidated statement of earnings related to the accretion of the discount recorded for earnout obligations in connection with our acquisitions. In addition, during the three-month periods ended March 31, 2018 and 2017, we recognized $2.3 million of expense and $6.7 million of expense, respectively, related to net adjustments in the estimated fair value of earnout obligations in connection with revised projections of future performance for 39 and 40 acquisitions, respectively. The aggregate amount of maximum earnout obligations related to acquisitions was $571.0 million as of March 31, 2018, of which $270.9 million was recorded in our consolidated balance sheet as of March 31, 2018, based on the estimated fair value of the expected future payments to be made.

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The following is a summary of the estimated fair values of the net assets acquired at the date of each acquisition made in the three-month period ended March 31, 2018 (in millions):

	MFG	M&A	Five Other Acquisitions	Total
Cash	$ 0.1	$	$ 0.1	$ 0.2
Other current assets	3.0	0.5	4.0	7.5
Fixed assets	0.4	1.4	0.3	2.1
Goodwill	24.7	5.2	11.1	41.0
Expiration lists	20.2	15.1	10.9	46.2
Non-compete agreements	0.1	0.1	0.2	0.4
Total assets acquired	48.5	22.3	26.6	97.4
Current liabilities	2.3	0.4	3.6	6.3
Noncurrent liabilities	0.4	0.8	1.7	2.9
Total liabilities assumed	2.7	1.2	5.3	9.2
Total net assets acquired	$ 45.8	$ 21.1	$ 21.3	$ 88.2

Among other things, these acquisitions allow us to expand into desirable geographic locations, further extend our presence in the retail and wholesale insurance brokerage services and risk management industries and increase the volume of general services currently provided. The excess of the purchase price over the estimated fair value of the tangible net assets acquired at the acquisition date was allocated to goodwill, expiration lists and non-compete agreements in the amounts of $41.0 million, $46.2 million and $0.4 million, respectively, within the brokerage and risk management segments.

Provisional estimates of fair value are established at the time of each acquisition and are subsequently reviewed within the first year of operations subsequent to the acquisition date to determine the necessity for adjustments. The fair value of the tangible assets and liabilities for each applicable acquisition at the acquisition date approximated their carrying values. The fair value of expiration lists was established using the excess earnings method, which is an income approach based on estimated financial projections developed by management for each acquired entity using market participant assumptions. Revenue growth and attrition rates generally ranged from 3.0% to 3.5% and 5.0% to 10.0%, respectively, for our 2017 acquisitions for which valuations were performed in 2018. We estimate the fair value as the present value of the benefits anticipated from ownership of the subject customer list in excess of returns required on the investment in contributory assets necessary to realize those benefits. The rate used to discount the net benefits was based on a risk-adjusted rate that takes into consideration market-based rates of return and reflects the risk of the asset relative to the acquired business. These discount rates generally ranged from 12.0% to 14.0% for our 2017 acquisitions for which valuations were performed in 2018. The fair value of non-compete agreements was established using the profit differential method, which is an income approach based on estimated financial projections developed by management for the acquired company using market participant assumptions and various non-compete scenarios.

Expiration lists, non-compete agreements and trade names related to our acquisitions are amortized using the straight-line method over their estimated useful lives (two to fifteen years for expiration lists, two to five years for non-compete agreements and two to fifteen years for trade names), while goodwill is not subject to amortization. We use the straight-line method to amortize these intangible assets because the pattern of their economic benefits cannot be reasonably determined with any certainty. We review all of our intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings as a component of amortization expense.

Of the $46.2 million of expiration lists and $0.4 million of non-compete agreements related to our acquisitions made during the three-month period ended March 31, 2018, $6.3 million and $0.1 million, respectively, is not expected to be deductible for income tax purposes. Accordingly, we recorded a deferred tax liability of $1.8 million, and a corresponding amount of goodwill, in the three-month period ended March 31, 2018, related to nondeductible amortizable intangible assets.

Our consolidated financial statements for the three-month period ended March 31, 2018 include the operations of the acquired entities from their respective acquisition dates. The following is a summary of the unaudited pro forma historical results, as if these entities had been acquired at January 1, 2017 (in millions, except per share data):

	Three-month period ended March 31,	
	2018	**2017**
Total revenues	$ 1,839.5	$ 1,653.7
Net earnings attributable to controlling interests	273.8	229.3
Basic net earnings per share	1.51	1.28
Diluted net earnings per share	1.48	1.27

The unaudited pro forma results above have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had these acquisitions occurred at January 1, 2017, nor are they necessarily indicative of future operating results. Annualized revenues of entities acquired during the three-month period ended March 31, 2018 totaled approximately $29.9 million. For the three-month period ended March 31, 2018, total revenues and net earnings recorded in our unaudited consolidated statement of earnings related to our acquisitions made during the three-month period ended March 31, 2018 in the aggregate, were $6.2 million and $0.6 million, respectively.

5. Other Current Assets

Major classes of other current assets consist of the following (in millions):

	March 31, 2018	December 31, 2017

Premium finance advances and loans	$	246.8	$	305.5
Accrued supplemental, direct bill and other receivables		229.7		244.5
Refined coal production related receivables		128.8		156.8
Contract costs		48.9		83.3
Prepaid expenses		95.0		91.5
Total other current assets	$	749.2	$	881.6

The premium finance loans represent short-term loans which we make to many of our brokerage related clients and other non-brokerage clients to finance their premiums paid to underwriting enterprises. These premium finance loans are primarily generated by three Australian and New Zealand premium finance subsidiaries. Financing receivables are carried at amortized cost. Given that these receivables carry a fairly rapid delinquency period of only seven days post payment date, and that contractually the majority of the underlying insurance policies will be cancelled within one month of the payment due date in normal course, there historically has been a minimal risk of not receiving payment, and therefore we do not maintain any significant allowance for losses against this balance.

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6. Intangible Assets

The carrying amount of goodwill at March 31, 2018 and December 31, 2017 allocated by domestic and foreign operations is as follows (in millions):

At March 31, 2018	Brokerage	Risk Management	Corporate	Total	
United States	$ 2,315.9	$ 25.1	$	$ 2,341.0	
United Kingdom	776.0	7.6		783.6	
Canada	367.8			367.8	
Australia	414.1				
Internet operating expenses	14,050	13,361	16,722	20,889	**25,145**
Publishing operating expenses	11,817	10,237	11,226	11,475	**12,288**
Corporate expenses	20,040	14,005	16,613	17,503	**18,892**
Depreciation and amortization	16,136	15,120	14,588	14,971	**14,647**
Cost of denied tower site, abandoned projects and terminated transactions	1,275	1,111			
Impairment of long-lived assets	73,010	27,996			**6,896**
(Gain) loss on disposal of assets	(6,892)	1,676	255	(4,153)	**49**
Total operating expenses	254,317	191,612	169,825	176,167	**198,689**
Operating income (loss) from continuing operations	(31,827)	7,601	36,633	41,999	**30,490**
Other income (expense):					
Interest income	247	290	183	344	**106**
Interest expense	(22,381)	(20,079)	(30,297)	(27,665)	**(24,911)**
Change in fair value of interest rate swaps	(4,827)	(781)			
Gain on bargain purchase		1,634			
Gain (loss) on early retirement of long-term debt	4,664	(1,050)	(1,832)	(2,169)	**(1,088)**
Other income (expense)	121	(88)	(16)	(40)	**79**
Total other expense	(22,176)	(20,074)	(31,962)	(29,530)	**(25,814)**
Income (loss) from continuing operations before income taxes	(54,003)	(12,473)	4,671	12,469	**4,676**
Provision for (benefit from) income taxes	(19,151)	(4,210)	2,695	6,110	**153**
Income (loss) from continuing operations	(34,852)	(8,263)	1,976	6,359	**4,523**
Income (loss) from discontinued operations, net of tax	1,766	(83)	(44)	(741)	**(95)**
Net income (loss)	$ (33,086)	$ (8,346)	$ 1,932	$ 5,618	**$ 4,428**
Basic earnings (loss) per share data:					
Earnings (loss) per share from continuing operations	$ (1.47)	$ (0.35)	$ 0.08	$ 0.26	**$ 0.18**
Income (loss) from discontinued operations	0.07			(0.03)	
Net earnings (loss) per share	$ (1.40)	$ (0.35)	$ 0.08	$ 0.23	**$ 0.18**
Diluted earnings (loss) per share data:					
Earnings (loss) per share from continuing operations	$ (1.47)	$ (0.35)	$ 0.08	$ 0.26	**$ 0.18**
Earnings (loss) per share from discontinued operations	0.07			(0.03)	
Net earnings (loss) per share	$ (1.40)	$ (0.35)	$ 0.08	$ 0.23	**$ 0.18**
Dividends per share	$	$	$ 0.20	$	**$ 0.14**
Basic weighted average shares outstanding	23,671,288	23,803,864	24,086,829	24,475,102	**24,577,605**
Diluted weighted average shares outstanding	23,671,288	23,803,864	24,653,465	24,683,644	**24,986,966**

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ITEM 6. SELECTED FINANCIAL DATA (CONTINUED).

	Year Ended December 31,				
	2008	2009	2010	2011	**2012**
	(Dollars in thousands)				
Balance Sheet Data:					
Cash and cash equivalents	$ 1,892	$ 8,945	$ 828	$ 67	**$ 380**
Broadcast licenses	398,135	375,317	378,362	371,420	**373,720**
Other intangible assets including goodwill, net	25,574	22,484	25,122	28,522	**33,009**
Total assets	607,718	579,045	574,486	561,310	**559,227**
Long-term debt (including current portion)	325,375	314,047	304,527	274,803	**268,980**
Stockholders equity	203,116	197,199	196,404	203,048	**206,069**
Cash flows related to:					
Operating activities	$ 37,901	$ 39,468	$ 22,817	$ 31,705	**$ 30,849**
Investing activities	(21,817)	(2,851)	(13,777)	(4,511)	**(19,066)**
Financing activities	(25,004)	29,481	(16,150)	(28,074)	**(11,469)**
Other Data:					
Station operating income (1)	$ 69,232	$ 63,949	$ 64,512	$ 63,249	**$ 62,408**
Station operating income margin (2)	35.7%	37.2%	36.9%	35.4%	**34.1%**

(1) We define station operating income as net broadcast revenue less broadcast operating expenses.
(2) Station operating income margin is station operating income as a percentage of net broadcast revenue.

Station operating income (SOI) is not a measure of performance calculated in accordance with generally accepted accounting principles (GAAP). Therefore, SOI should be viewed as a supplement to and not a substitute for results of operations presented on the basis of GAAP. Management believes that station operating income is useful, 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 by analysts who report on the industry to provide comparisons between broadcast groups. Additionally, we use SOI as one of our key measures of operating efficiency and contribution to profitability. Station operating income 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. Our SOI is not necessarily comparable to similarly titled measures employed by other companies.

RECONCILIATION OF STATION OPERATING INCOME TO NET INCOME (LOSS)

	Year Ended December 31,				
	2008	2009	2010	2011	**2012**
	(Dollars in thousands)				
Station operating income	$ 69,232	$ 63,949	$ 64,512	$ 63,249	**$ 62,408**
Plus Internet revenue	16,583	16,232	20,104	27,304	**33,474**
Plus publishing revenue	11,794	10,926	11,421	12,131	**12,525**
Less Internet operating expenses	(14,050)	(13,361)	(16,722)	(20,889)	**(25,145)**
Less publishing operating expenses	(11,817)	(10,237)	(11,226)	(11,475)	**(12,288)**
Less corporate expenses	(20,040)	(14,005)	(16,613)	(17,503)	**(18,892)**
Less depreciation and amortization	(16,136)	(15,120)	(14,588)	(14,971)	**(14,647)**
Less cost of denied tower site, abandoned projects and terminated transactions	(1,275)	(1,111)			
Less impairment of long-lived assets	(73,010)	(27,996)			**(6,896)**
Less gain (loss) on disposal of assets	6,892	(1,676)	(255)	4,153	**(49)**
Operating income (loss) from continuing operations	$ (31,827)	$ 7,601	$ 36,633	$ 41,999	**$ 30,490**
Plus interest income	247	290	183	344	**106**

Less interest expense	(22,381)	(20,079)	(30,297)	(27,665)	**(24,911)**
Less change in fair value of interest rate swaps	(4,827)	(781)			
Plus gain on bargain purchase		1,634			
Less gain (loss) on early retirement of long-term debt	4,664	(1,050)	(1,832)	(2,169)	**(1,088)**
Less other income (expense)	121	(88)	(16)	(40)	**79**
Less provision for (benefit from) income taxes	19,151	4,210	(2,695)	(6,110)	**(153)**
Less income (loss) from discontinued operations	1,766	(83)	(44)	(741)	**(95)**
Net income (loss)	$ (33,086)	$ (8,346)	$ 1,932	$ 5,618	**$ 4,428**

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ITEM 7. 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 consolidated financial statements and related notes included elsewhere in this report. Our consolidated financial statements are not directly comparable from period to period due to acquisitions and dispositions of selected radio station assets and Internet and publishing businesses. Refer to Note 3 of our consolidated financial statements under Item 8 for details of each of these transactions.

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. We maintain a website at 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 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.

Our rates for broadcast time and advertising time vary based 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.

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. In markets where we subscribe to Arbitron under the PPM, our ratings have been less consistent. PPM data can fluctuate when changes are made to the panel (a group of individuals holding PPM devices). This makes all stations susceptible to some inconsistencies in ratings that may or may not accurately reflect the actual number of listeners at any given time.

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. Quarterly revenue from the sale of block programming time does not tend to vary significantly, however, 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 27 News Talk stations, 11 Contemporary Christian Music stations, 10 Business format stations, and seven 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 2012, 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.

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 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 Consolidated Statements of Operations.

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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.

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 calculated as the sum of the same station-results for each of the four quarters of that year.

RESULTS OF OPERATIONS

Year ended December 31, 2012 compared to year ended December 31, 2011

The following factors affected our results of operations for the year ended December 31, 2012 as compared to the prior year:

Financing

On December 12, 2012, we redeemed $4.0 million of the $9^5/_8$% Notes for $4.1 million, or at a price equal to 103% of the face value. This transaction resulted in a $0.2 million pre-tax loss on the early retirement of debt, including approximately $17,000 of unamortized discount and $0.1 million of bond issue costs associated with the $9^5/_8$% Notes.

On June 1, 2012, we redeemed $17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

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 December 31, 2012, $7.5 million was outstanding on the FCB Loan.

On May 21, 2012, we entered into an additional subordinated 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 subordinated 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, 2012, $15.0 million was outstanding on all of our Subordinated Debt due to Related Parties, including amounts due Mr. Epperson.

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. Common stock dividends of $0.9 million, or $0.035 per share, were paid on March 30, 2012, June 29, 2012, September 28, 2012 and December 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 October 1, 2012, we completed the acquisition of Godvine.com for $4.2 million. Godvine is a Christian video website and media platform that increases our online presence and offers significant exposure on Facebook with now over 3.3 million Facebook fans. We believe that the addition of Godvine.com makes SWN the largest online destination for Christian content with an average of 5.8 million unique visits per month.

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. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition 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 attributable to the organizational systems and procedures already in place to ensure effective operations of the business.

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. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date.

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 previous owner on November 1, 2011. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the TBA date. The accompanying Consolidated Balance Sheets reflect the net assets of this entity as of the closing date.

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. The accompanying Consolidated Statements of Operations reflect the operating results of this entity through the date of the sale.

Net Broadcasting Revenue

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Net Broadcast Revenue	$ 178,731	$ 183,180	$ 4,449	2.5%	81.9%	79.9%
Same Station Net Broadcast Revenue	$ 178,025	$ 182,106	$ 4,081	2.3%		

Net broadcast revenues increased due to overall improving economic conditions and a greater demand for radio airtime as compared to the same period of the prior year. Included in these results are a $3.3 million increase in political advertisements and a $1.8 million increase in block programming revenue primarily from our Christian Teaching and Talk formatted stations partially offset by a $0.2 million decline in infomercial revenue and a $0.2 million decline in local spot local advertising. Block programming results reflect annual rate increases while national advertising results reflect higher sales volume due to advertisers purchasing more airtime.

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

	Year Ended December 31,			
	2011		**2012**	
	(Dollars in thousands)			
Block program time:				
National	$ 42,812	24.0%	**$ 43,468**	**23.7%**
Local	31,227	17.5	**32,321**	**17.7**
	74,039	41.5	**75,789**	**41.4**
Advertising:				
National	13,426	7.5	**14,200**	**7.8**
Local	63,446	35.5	**63,233**	**34.5**

	76,872	43.0	**77,433**	**42.3**
Infomercials	6,303	3.5	**6,112**	**3.3**
Network	14,699	8.2	**16,083**	**8.8**
Other	6,818	3.8	**7,763**	**4.2**
Net broadcast revenue	$ 178,731	100.0%	**$ 183,180**	**100.0%**

Internet Revenue

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Internet Revenue	$ 27,304	$ 33,474	$ 6,170	22.6%	12.5%	14.6%

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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 radio station branded websites, increased $4.5 million, including $0.9 million of political revenue, due primarily to higher demand for placement from advertisers and secondarily to rate increases. Video and graphic downloads increased $1.6 million over the prior year due to higher volumes.

Publishing Revenue

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Publishing Revenue	$12,131	$ 12,525	$ 394	3.2%	5.6%	5.5%

Publishing revenue increased due to higher submission fees and book sales from Xulon Press partially offset by declines in subscription revenues from our print magazines. Our print magazines, and the print magazine industry as a whole, have continued to experience declines in the number of subscribers.

Broadcast Operating Expenses

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Broadcast Operating Expenses	$ 115,482	$ 120,772	$ 5,290	4.6%	52.9%	52.7%
Same Station Net Broadcast Operating Expenses	$ 114,930	$ 119,745	$ 4,815	4.2%		

Broadcast operating expenses increased due to higher variable expenses associated with higher revenues, including a $3.3 million increase in personnel-related costs including commissions and new local talent, a $0.8 million increase in facility related costs, a $0.4 million increase in advertising expenses, a $0.5 million increase in production and programming costs, a $0.1 million increase in LMA fees, and a $0.2 million increase in music license fees partially offset by a reduction in bad debt expense of $0.4 million.

Internet Operating Expenses

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Internet Operating Expenses	$ 20,889	$ 25,145	$ 4,256	20.4%	9.6%	11.0%

Internet operating expenses increased due to higher variable expenses associated with higher revenues, including a $1.9 million increase in personnel-related costs including commissions, a $0.8 million increase in royalty expense, a $0.7 million increase in advertising expense, a $0.3 million increase in streaming and hosting, a $0.1 million increase in product costs related to SCP, and $0.4 million increase in bad debt expense.

Publishing Operating Expenses

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Publishing Operating Expenses	$ 11,475	$ 12,288	$ 813	7.1%	5.3%	5.4%

Operating expenses for Xulon Press increased due to higher variable costs associated with revenue growth. These costs include an increase of $0.8 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

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Corporate Expenses	$ 17,503	$ 18,892	$ 1,389	7.9%	8.0%	8.2%

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Corporate expenses include shared general and administrative services. Higher costs include a $0.9 million in personnel-related costs primarily due to strategic new-hires, a $0.3 million increase in non-cash stock-based compensation expense and a $0.3 million increase in accounting and public reporting costs partially offset by a $0.1 million decrease in repairs and maintenance.

Depreciation Expense

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Depreciation Expense	$ 12,520	$ 12,343	$ (177)	(1.4) %	5.7%	5.4%

Depreciation expense decreased slightly due to approximately $1.4 million of computer software and website development costs acquired in 2008 that were fully depreciated during the prior year offset by a $0.5 million net increase in capital expenditures placed in service during the current year as well as the composite of current year acquisitions. During 2012 we acquired approximately $0.5 million of buildings and towers with longer estimated useful lives of thirty to thirty five years compared to the prior year in which computer software and website development costs were recorded with useful lives of three years.

Amortization Expense

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Amortization Expense	$ 2,451	$ 2,304	$ (147)	(6.0)%	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.

Impairment of Long-Lived Assets

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Impairment of Long-Lived Assets	$	$ 6,896	$ 6,896	100.0%	%	3.0%

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 based on the estimated sale price. In December 2012, after several purchase offers for the land were terminated, we obtained a third party valuation for the land. Based on this fair value appraisal, we recorded an additional $1.2 million impairment charge associated with the land. We completed our annual impairment testing for goodwill and other indefinite-lived intangible assets during the fourth quarter of 2012. As a result of our annual testing, we recorded a $0.1 million impairment on mastheads in our publishing segment. This impairment was driven by a reduction in publishing revenue specifically from our print magazines and is a trend in the industry as a whole that is not unique to our operations.

(Gain) Loss on disposal of assets

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
(Gain) loss on disposal of assets	$ (4,153)	$ 49	$ 4,202	(101.2) %	(1.9)%	%

The net gain on disposal of assets for the twelve months ended December 31, 2012, includes a $0.2 million pre-tax gain on the sale of WBZS-AM in Pawtucket, Rhode Island and a $0.6 million gain from insurance proceeds for repairs of storm damage in our New York market, 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.

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Other income (expense), net

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Interest Income	$ 344	$ 106	$ (238)	(69.2)%	0.2%	%
Interest Expense	(27,665)	(24,911)	2,754	(10.0)%	(12.7)%	(10.9)%
Loss on early retirement of long-term debt	(2,169)	(1,088)	1,081	(49.8)%	(0.9)%	(0.5)%
Other Income (Expense)	(40)	79	119	(297.5)%	%	%

Interest income represents earnings on excess cash. The decrease in interest expense is due to the lower principal balance outstanding on the $9^5/_8$% Notes, partially offset by higher interest on amounts outstanding under 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 $1.1 million for the year ended December 31, 2012 compared to $2.2 million for the same period of the prior year represents the redemptions at a price equal to 103% of the face value and open market repurchases in each period of principle amounts of the $9^5/_8$% Notes.

Provision for (benefit from) income taxes

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Provision for (benefit from) income taxes	$ 6,110	$ 153	$ (5,957)	(97.5)%	2.8%	0.1%

In accordance with FASB ASC Topic 740 Income Taxes, our provision for income taxes was $0.2 million for the year ended December 31, 2012 compared to a tax provision of $6.1 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 3.3% for the year ended December 31, 2012 compared to 49.0% 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 year ended December 31, 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.

Income (loss) from discontinued operations, net of tax

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Income (loss) from discontinued operations, net of tax	$ (741)	$ (95)	$ 646	(87.2)%	(0.3)%	%

The loss from discontinued operations of $0.7 million and $0.1 million, respectively, for the years ended December 31, 2012 and 2011 relate to the operating results of Samaritan Fundraising that ceased operations in December 2011.

Net Income (Loss)

	Year Ended December 31,					
	2011	**2012**	Change $	Change %	2011	**2012**
	(Dollars in thousands)				% of Total Net Revenue	
Net Income (Loss)	$ 5,618	$ 4,428	$ (1,190)	(21.2)%	2.6%	1.9%

Net income decreased $1.2 million from the prior year due to a $6.9 million impairment of long-lived assets, a $5.3 million increase in broadcast operating expenses and a $4.2 million increase in internet operating expenses offset by an $11.0 million increase in net revenues and a $2.8 million reduction in interest expense.

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Year ended December 31, 2011 compared to year ended December 31, 2010

The following factors affected our results of operations for the year ended December 31, 2011 as compared to the prior year:

Financing

On December 12, 2011, we redeemed $12.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On November 17, 2011, Salem entered into subordinated 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 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. The proceeds of the subordinated lines of credit may be used to repurchase a portion of Salem s outstanding senior secured notes. Amounts outstanding under each subordinated line of credit bear interest at an amount equal to the lesser of (1) 5% per annum and (2) the maximum rate permitted for subordinated debt under the Credit Agreement referred to above plus 2% per annum. The indebtedness under the subordinated lines of credit is subordinated to the indebtedness under the Salem credit facility described above pursuant to a subordination agreement to be entered into among Wells Fargo, Salem and the Affiliate Lenders and the description of terms herein is subject to such subordination agreement. The subordinated lines of credit (together, Subordinated Debt due to Related Parties) do not contain any covenants. At December 31, 2011, $9.0 million was outstanding under the Subordinated Debt due to Related Parties

On November 15, 2011, we completed the Second Amendment to 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. 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. We incurred $0.5 million in fees to complete this amendment, which are being amortized over the remaining term of the credit agreement.

On September 6, 2011, we repurchased $5.0 million of the $9^5/_8$% Notes for $5.1 million, or at a price equal to $102^7/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On June 1, 2011, we redeemed $17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

Acquisitions

On December 21, 2011, we completed the acquisition of KTEK-AM in Houston, Texas for $2.6 million, which includes $1.0 million of cash and $1.6 million netted against the unpaid portion of our note receivable. We began operating the station on March 5, 2010, pursuant to a long-term TBA. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the TBA date. The accompanying Consolidated Balance Sheets reflect the net assets of this entity as of the acquisition date. We previously sold the assets of KTEK-AM on March 28, 2008 for $7.8 million, which included $4.5 million in cash and $3.3 million in notes receivable of which we collected $1.8 million. Our 2011 purchase was partially funded by the unpaid portion of the note of $1.5 million.

On March 28, 2011, we completed the acquisition of the Internet business, WorshipHouseMedia, an on-line church media and video ministry website, for $6.0 million in cash. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date. The acquisition resulted in goodwill of $2.1 million representing the excess value of the business resulting from the integrated business model and services already established that provide future economic benefits to us.

On March 14, 2011, we completed the acquisition of radio station WDDZ-AM, Pawtucket, Rhode Island, for $0.6 million in cash. We began operating the station as WBZS-AM upon the close of the transaction. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date. On January 5, 2012, we entered into an asset purchase agreement to sell this radio station for $0.8 million.

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On January 3, 2011, we began programming radio station KVCE-AM, Highland Park, Texas pursuant to a long-term TBA.

Dispositions

On March 1, 2011, we completed the sale of radio station WAMD-AM in Aberdeen, Maryland resulting in a pre-tax loss of $0.2 million. The loss was recognized in September 2010 upon entering the sale agreement.

On February 25, 2011, we completed the sale of radio station KXMX-AM in Los Angeles, California for $12.0 million, consisting of $11.0 million in cash and a $1.0 million promissory note. The $1.0 million promissory note has a three-year term, bearing interest at 7% compounded annually, due February 25, 2016. We recognized a pre-tax gain of $2.1 million from the sale.

On January 6, 2011, we completed the sale of radio station KKMO-AM in Seattle, Washington for $2.7 million in cash resulting in a pre-tax gain of $2.4 million.

Net Broadcasting Revenue

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Net Broadcast Revenue	$ 174,933	$ 178,731	$ 3,798	2.2%	84.7%	81.9%
Same Station Net Broadcast Revenue	$ 170,908	$ 175,957	$ 5,049	3.0%		

Net broadcast revenues increased due to overall improving economic conditions and a greater demand for radio advertising compared to the prior year. Our results reflect higher sales volume in the number of minutes sold with little change in the rates we charge our customers.

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

	Year Ended December 31,			
	2010		**2011**	
	(Dollars in thousands)			
Block program time:				
National	$ 38,736	22.1%	**$ 42,812**	**24.0%**
Local	31,848	18.2	**31,227**	**17.5**
	70,584	40.3	**74,039**	**41.5**
Advertising:				
National	14,200	8.1	**13,426**	**7.5**
Local	61,494	35.2	**63,446**	**35.5**
	75,694	43.3	**76,872**	**43.0**
Infomercials	6,661	3.8	6,303	3.5
Network	15,657	9.0	**14,699**	**8.2**
Other	6,337	3.6	**6,818**	**3.8**
Net broadcast revenue	$ 174,933	100.0%	**$ 178,731**	**100.0%**

Internet Revenue

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Internet Revenue	$ 20,104	$ 27,304	$ 7,200	35.8%	9.7%	12.5%

The increase in Internet revenues reflect improving overall economic conditions and higher demand for banner advertisements as well as growth from acquisitions that generate revenues across all of our web-based platforms. The increases are driven primarily by a higher sales volume and secondarily to higher rates charged to our customers. Banner advertisements, including those on our station websites, increased $4.0 million due to higher demand. WorshipHouseMedia, which we acquired in March 2011, generated revenue of $2.7 million and Salem Consumer Products revenues increased $0.4 million.

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Publishing Revenue

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Publishing Revenue	$ 11,421	$ 12,131	$ 710	6.2%	5.5%	5.6%

Publishing revenue increased $0.9 million based on higher submission fees and book sales from Xulon Press partially offset by a $0.2 million decline in subscription revenues from our print magazines based on a lower number of subscribers.

Broadcast Operating Expenses

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Broadcast Operating Expenses	$ 110,421	$ 115,482	$ 5,061	4.6%	53.5%	52.9%
Same Station Net Broadcast Operating Expenses	$ 107,232	$ 113,061	$ 5,829	5.4%		

Broadcast operating expenses increased due to higher variable expenses associated with higher revenues, including a $2.3 million increase in personnel-related costs including commissions, a $1.0 million increase in production and programming expenses, a $0.6 million increase in facility related costs, a $0.4 million increase in music license fees, a $0.4 million increase in bad debt expense and a $0.3 million increase in professional services.

Internet Operating Expenses

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Internet Operating Expenses	$ 16,722	$ 20,889	$ 4,167	24.9%	8.1%	9.6%

Internet operating expenses increased due to higher variable expenses associated with higher revenues, including a $1.8 million increase in personnel-related costs including commissions, a $1.3 million increase in royalty expenses, a $0.3 million increase in advertising expenses incurred to promote our Internet businesses, as well as a $0.8 million increase in streaming, hosting and software expenses.

Publishing Operating Expenses

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Publishing Operating Expenses	$ 11,226	$ 11,475	$ 249	2.2%	5.4%	5.3%

Publishing operating expenses increased from Xulon Press, our digital book publishing service that incurred higher variable costs associated with revenue growth. These costs include an increase of $0.1 million in personnel-related costs including commissions and a $0.1 million increase in advertising expense partially offset by lower printing costs associated with reduced distribution levels of our print magazines.

Corporate Expenses

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	

Corporate Expenses	$ 16,613	$ 17,503	$ 890	5.4%	8.0%	8.0%

Corporate expenses include shared general and administrative services. The increase of $0.9 million includes a $1.5 million increase in personnel-related costs and a $0.1 million increase in professional services, offset by a $0.4 million decrease in non-cash stock-based compensation expense, a $0.2 million decrease in repair and maintenance costs and a $0.2 million decrease in facility-related costs.

Depreciation Expense

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Depreciation Expense	$ 12,570	$ 12,520	$ (50)	(0.4)%	6.1%	5.7%

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Depreciation expense remained flat because of reductions in capital expenditures and acquisition related activity, primarily in our broadcast operating segment.

Amortization Expense

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Amortization Expense	$ 2,018	$ 2,451	$ 433	21.5%	1.0%	1.1%

Amortization expense increased primarily due to the acquisitions of intangible assets from our 2010 acquisitions of HotAir.com and GodTube.com and our 2011 acquisition of WorshipHouseMedia. These intangible assets include customer lists and domain names with useful lives of between one and five years.

(Gain) Loss on disposal of assets

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
(Gain) loss on disposal of assets	$ 255	$ (4,153)	$ (4,408)	(1,728.6)%	0.1%	(1.9)%

The net gain on disposal of assets of $4.2 million for the year ended December 31, 2011, 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, offset by various fixed asset and equipment disposals. The net loss on disposal of assets of $0.3 million for the same period of the prior year is comprised of a $0.2 million pre-tax loss on the sale of WAMD-AM, Aberdeen, Maryland, a $0.2 million pre-tax loss from the sale of Chicago real estate associated with the relocation of our Radio Division President and $0.2 million of losses from various fixed asset and equipment disposals offset by a $0.3 million pre-tax gain from the eminent domain seizure of property by the Dallas County School District.

Other income (expense), net

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Interest Income	$ 183	$ 344	$ 183	88.0%	0.1%	0.2%
Interest Expense	(30,297)	(27,665)	2,632	(8.7)%	(14.7)%	(12.7)%
Loss on early retirement of long-term debt	(1,832)	(2,169)	(337)	18.4%	(0.1)%	(0.9)%
Other Income (Expense)	(16)	(40)	(24)	150.0%	0.1%	%

Interest income of $0.3 million and $0.2 million for the years ended December 31, 2011 and 2010 represents earnings on excess cash. The decrease in interest expense is due to the lower principal balance outstanding on the $9^5/_8$% Notes, partially offset by higher interest on the outstanding balances on our Revolver. Loss on early retirement of debt represents the redemptions and open market repurchases in each period of principle amounts of the $9^5/_8$% Notes at a price equal to 103% of the face value.

Provision for (benefit from) income taxes

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Provision for (benefit from) income taxes	$ 2,695	$ 6,110	$ 3,415	126.7%	1.3%	2.8%

In accordance with FASB ASC Topic 740 Income Taxes, our provision for income taxes was $6.1 million for the year ended December 31, 2011 compared to a tax benefit of $2.7 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 49.0% for the year ended December 31, 2011 compared to 57.7% 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.

Income (loss) from discontinued operations, net of tax

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Income (loss) from discontinued operations, net of tax	$ (44)	$ (741)	$ (697)	1,584.1%	%	(0.3)%

The loss from discontinued operations of $0.7 million and $44,000, respectively, for the years ended December 31, 2011 and 2010 relate to the operating results of Samaritan Fundraising that ceased operations in December 2011.

Net Income (Loss)

	Year Ended December 31,					
	2010	**2011**	Change $	Change %	2010	**2011**
	(Dollars in thousands)				% of Total Net Revenue	
Net Income (Loss)	$ 1,932	$ 5,618	$ 3,686	190.7%	0.9%	2.6%

Net income increased $3.7 million from the prior year due to a $5.4 million increase in our net operating income and a $2.6 million decrease in interest expense offset by a $3.4 million increase in our tax provision, a $0.4 million increase in losses associated with the early redemption of $35.0 million of the $9^5/_8$% Notes, and a $0.7 million increase in the loss associated with the discontinued operations of Samaritan Fundraising.

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 (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.

Year ended December 31, 2012 compared to year ended December 31, 2011

STATION OPERATING INCOME. SOI decreased $0.8 million, or 1.3%, to $62.4 million for the year ended December 31, 2012 compared to $63.2 million for the same period of the prior year as a result of the changes in net broadcast revenue and broadcast operating expense explained above. As a percentage of net broadcast revenue, SOI decreased to 34.1% for the year ended December 31, 2012 from 35.4% for the same period of the prior year. On a same station basis, SOI decreased $0.7 million, or 1.2%, to $62.4 million for the year ended December 31, 2012 from $63.1 million for the same period of the prior year. As a percentage of same station net broadcast revenue, same station SOI decreased to 34.2% for the year ended December 31, 2012, compared to 35.4% for the same period of the prior year.

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The following table provides a reconciliation of SOI (a non-GAAP financial measure) to net income (as presented in our financial statements) for the year ended December 31, 2011 and 2012:

	Year Ended December 31, 2011	Year Ended December 31, 2012
	(Dollars in thousands)	
Station operating income	$ 63,249	**$ 62,408**
Plus Internet revenue	27,304	**33,474**
Plus publishing revenue	12,131	**12,525**
Less Internet operating expenses	(20,889)	**(25,145)**
Less publishing operating expenses	(11,475)	**(12,288)**
Less corporate expenses	(17,503)	**(18,892)**
Less depreciation and amortization	(14,971)	**(14,647)**
Less impairment of long-lived assets		**(6,896)**
Less gain (loss) on disposal of assets	4,153	**(49)**
Operating income from continuing operations	$ 41,999	**$ 30,490**
Plus interest income	344	**106**
Less interest expense	(27,665)	**(24,911)**
Less loss on early retirement of long-term debt	(2,169)	**(1,088)**
Less other income (expense)	(40)	**79**
Less provision for (benefit from) income taxes	(6,110)	**(153)**
Less income (loss) from discontinued operations	(741)	**(95)**
Net income	$ 5,618	**$ 4,428**

Year ended December 31, 2011 compared to year ended December 31, 2010

STATION OPERATING INCOME. SOI decreased $1.3 million, or 2.0%, to $63.2 million for the year ended December 31, 2011 compared to $64.5 million for the same period of the prior year as a result of the changes in net broadcast revenue and broadcast operating expense explained above. As a percentage of net broadcast revenue, SOI decreased to 35.4% for the year ended December 31, 2011 from 36.9% for the same period of the prior year. On a same station basis, SOI decreased $0.8 million, or 1.2%, to $62.9 million for the year ended December 31, 2011 from $63.7 million for the same period of the prior year. As a percentage of same station net broadcast revenue, same station SOI decreased to 35.7% for the year ended December 31, 2011, compared to 37.3% for the same period of the prior year.

The following table provides a reconciliation of SOI (a non-GAAP financial measure) to net income (as presented in our financial statements) for the year ended December 31, 2010 and 2011:

	Year Ended December 31, 2010	Year Ended December 31, 2011
	(Dollars in thousands)	
Station operating income	$ 64,512	**$ 63,249**
Plus Internet revenue	20,104	**27,304**
Plus publishing revenue	11,421	**12,131**
Less Internet operating expenses	(16,722)	**(20,889)**
Less publishing operating expenses	(11,226)	**(11,475)**
Less corporate expenses	(16,613)	**(17,503)**
Less depreciation and amortization	(14,588)	**(14,971)**
Less gain (loss) on disposal of assets	(255)	**4,153**
Operating income from continuing operations	$ 36,633	**$ 41,999**
Plus interest income	183	**344**

Less interest expense	(30,297)	**(27,665)**
Less loss on early retirement of long-term debt	(1,832)	**(2,169)**
Less other income (expense)	(16)	**(40)**
Less provision for (benefit from) income taxes	(2,695)	**(6,110)**
Less income (loss) from discontinued operations	(44)	**(741)**
Net income	$ 1,932	**$ 5,618**

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CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our 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 consolidated financial statements. For a more comprehensive list of our accounting policies, see Note 1, Significant Accounting Policies, of the accompanying the consolidated financial statements included in this annual report. Note 1 contains several other policies which are important to the preparation of our consolidated financial statements, but do not meet the SEC s definition of critical accounting policies because they do not involve subjective or complex judgments.

Accounting for acquisitions and upgrades of radio station and network assets

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 radio stations, networks, Internet businesses or 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 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 of these properties 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 is 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 was 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 or services received in such barter transactions is charged to expense as used. Barter advertising revenue included in broadcast revenue for the years ended December 31, 2010, 2011 and 2012 was approximately $4.6 million, $5.2 million and $5.3 million, respectively, and 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 was to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

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 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 were 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 periods presented.

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Goodwill and indefinite-lived intangible assets

Approximately 71% of our total assets as of December 31, 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 are 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 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 7 to our Consolidated Financial Statements.

Broadcast Licenses

The unit of accounting we use to test broadcast licenses is the cluster level, which we define as a group of radio stations operating in the same geographic market, sharing the same building and 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.

In July 2012, the FASB issued ASU 2012-02, Intangibles Goodwill and Other (Topic 350). Under ASU 2012-02, we have the option to assess whether it is more likely than not that an indefinite-lived intangible asset is impaired. If it is more likely than not that impairment exists, we are required to perform a quantitative analysis to estimate the fair value of the assets. The qualitative assessment requires significant judgment in considering events and circumstances that may affect the estimated fair value of our broadcast licenses and to weigh the events and circumstances by what we believe to be the strongest to weakest indicator of potential impairment. ASU 2012-02 is effective for annual and interim impairment tests for fiscal years beginning after September 15, 2012, with early adoption permitted. We adopted the provisions of ASU 2012-02 as of our 2012 annual testing period. During 2011 and prior years, we applied the start-up income approach to estimate the fair value of each of our broadcast licenses.

We reviewed the significant assumptions in our most recent fair value estimates that were completed during our annual testing period ending December 31, 2011. Our review included an assessment to determine if events and circumstances have occurred that could affect the significant inputs used in these fair value estimates. Our 2011 fair value calculations were prepared using the start-up income approach to estimate the fair value of the broadcast license. The start-up-income approach measures the expected future economic benefits that the broadcast licenses provide and discounts these future benefits using a discounted cash flow analysis. The discounted cash flow analysis assumes that the broadcast licenses hypothetical start-up stations and the values yielded by the discounted cash flow analysis represent the portion of the stations value attributable solely to the broadcast license. The discounted cash flow model incorporates variables such as projected revenues, operating profit margins, forecasted growth rates, estimated start-up costs, losses expected to be incurred in the early years, competition within the market, the effective tax rate, future terminal values and the risk-adjusted discount rate. The variables used reflect historical company growth trends, industry projections, and the anticipated performance of the business. The discounted cash flow projection period was determined to be ten years, which is typically the time radio station operators and investors expect to recover their investments as widely used by industry analysts in their forecasts.

The key estimates and assumptions used in the start-up income valuation for all of our broadcast licenses were as follows:

Broadcast Licenses	December 31, 2011
Discount rate	9.0%
Operating profit margin ranges	3.8% - 38.0%

Long-term market revenue growth rate ranges	**1.0% - 4.0%**

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We reviewed each of the key estimates and assumptions and determined that there have been no significant changes that would need to be applied to a hypothetical start-up station in order to estimate the fair value. Projected revenues, operating profit margins, forecasted growth rates, estimated start-up costs, losses expected to be incurred in the early years, competition within the market, the effective tax rate, future terminal values and the risk-adjusted discount rate are consistent with those applied in the 2011 testing period. We also reviewed internal benchmarks and economic performance for each of our markets to conclude that we could reasonably rely upon the 2011 fair value estimates and assumptions as a starting point to our qualitative analysis.

We calculated the amount by which the 2011 estimated fair values exceeded our carrying amounts to calculate the excess of fair value. We concluded that markets with broadcast licenses with a 25% or more excess of the estimated fair value over the carrying value were not likely to be impaired. We believe based on our analysis and review, including the financial performance of each market, that a 25% excess fair value margin is conservative and reasonable in the qualitative analysis.

The tables below present the percentage within a range by which the estimated fair value exceeded the carrying value of our broadcasting licenses for each of our clusters:

	Geographic Clusters as of December 31, 2012 Percentage Range By Which Fair Value Exceeds Carrying Value			
	£ 25%	>26-30%	>30% to 75%	> than 75%
Number of market clusters	**12**	**2**	**6**	**9**
Broadcast license carrying value (in thousands)	**$ 248,939**	**$ 22,112**	**$ 26,586**	**$ 76,082**

We considered the 12 markets with an excess fair value that was less than 25% of the carrying values to be more likely than not impaired. For these markets, we engaged Bond & Pecaro, an independent third-party appraisal and valuation firm to perform a quantitative appraisal of our broadcast licenses. Bond & Pecaro utilized the start-up income approach to value broadcast licenses. The key estimates and assumptions used in the Bond & Pecaro start-up income valuation for these selected markets were as follows:

Broadcast Licenses	**December 31, 2012**
Discount rate	**9.0%**
Operating profit margin ranges	**5.1% - 35.5%**
Long-term market revenue growth rate ranges	**0.3% - 15.0%**

The table below presents the results of our quantitative analysis for the annual testing period ending December 31, 2012:

Market Cluster	Excess Fair Value 2011 Estimate	Excess Fair Value 2012 Estimate
Atlanta, GA	13.34%	7.54%
Chicago, IL	11.85%	6.38%
Cleveland, OH	9.03%	2.23%
Dallas, TX	7.83%	10.38%
Detroit, MI	10.17%	4.69%
Louisville, KY	24.08%	7.21%
Miami, FL	14.93%	27.84%
Omaha, NE	14.36%	8.82%
Orlando, FL	19.36%	38.74%
Portland, OR	19.47%	11.00%
Sacramento, CA	10.46%	4.87%
Tampa, FL	16.17%	44.76%

Based on our review and analysis we determined that no impairment charges were necessary to the carrying value of our broadcast licenses as of the annual testing periods ending December 31, 2012. Based on prior tests, we determined that no impairments of our broadcast licenses were necessary for years ending December 31, 2011 or 2010, respectively.

Mastheads

Mastheads consist of the graphic elements that identify our publications to readers and advertisers. These include customized typeset page headers, section headers, and column graphics as well as other name and identity stylized elements within the body of each publication. We test the value of mastheads as a single combined publishing entity as our print magazines operate from one shared facility under one general manager with operating results and cash flows reported on a combined basis for all publications.

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Based on actual operating results as of our year end testing period that did not meet or exceed our expectations, we performed a quantitative review of mastheads as of our annual testing period ending December 31, 2012. We had also performed an interim valuation of mastheads as of June 30, 2012 in which our excess fair value was estimated to be only 1.7%. We engaged Bond & Pecaro, an independent third-party appraisal firm, to perform an income-based approach to determine the estimated fair value of our mastheads. The income approach is based upon an estimated royalty stream that measures a cost savings to the business because it does not have to pay a royalty to use the owned trade name and content. The analysis assumes that the assets are employed by a typical market participant in their highest and best use. Under the income approach, we utilize a discounted cash flow method to calculate the estimated fair value of our mastheads, the key estimates and assumptions to which are as follows:

Mastheads	December 31, 2010	December 31, 2011	Interim June 30, 2012	December 31, 2012
Discount rate	8.5%	8.5%	8.5%	**8.5%**
Projected revenue growth ranges	2.0% - 2.5%	1.5% - 2.50%	1.5% - 2.50%	**1.5% - 3.0%**
Royalty growth rate	3.0%	3.0%	3.0%	**3.0%**

We recognized an impairment charge of $0.1 million associated with the value of mastheads in our publishing segment as of the annual testing period ending December 31, 2012. The impairment was driven by a reduction in projected net revenues resulting from ongoing operating results that have not met expectations. The impairment was indicative of trends in the publishing industry as a whole and is not unique to our company or operations.

Goodwill Broadcast

During 2012, we adopted ASU 2011-08, Testing Goodwill for Impairment. As a result, beginning in 2012, the first step of the impairment tests for goodwill is a thorough assessment of qualitative factors to determine if events or circumstances indicate that it is not more likely than not that the fair value of these assets is less than their carrying amounts. If the qualitative test indicates it is not more likely than not that the fair value of these assets is less than their carrying amounts, a quantitative assessment is not required. The unit of accounting used to test broadcast licenses is the cluster level, which we define as a group of radio stations operating in the same geographic market, sharing the same building and equipment and managed by a single general manager. Nine of our 31 market clusters and our networks have goodwill associated with them as of our annual testing period ending December 31, 2012.

The first step of our review included an assessment to determine if events and circumstances have occurred that could affect the significant inputs used in our fair value estimates. We estimated fair values using a market and income approach and compared the estimated fair value of each cluster to its carrying value including goodwill. Using a market approach, we applied a multiple of four to each clusters station operating income (SOI) to calculate the estimated fair value. Radio stations are often sold on the basis of a multiple of projected cash flow, or SOI. Numerous trade organizations and analysts track these radio transactions. Based on reports and analysis of these transactions, we believe industry benchmarks to be in the six to seven times cash flow range. Based our analysis, we determined that an SOI benchmark of four would be a conservative indicator of fair value. Under the income approach, we utilized a discounted cash flow method to calculate the estimated fair value of the accounting unit. The discounted cash flow method incorporates the cumulative present value of the net after-tax cash flows projected for each market assuming that it is a hypothetical start-up station. The key estimates and assumptions used in the start-up income valuation of our broadcast markets for each testing period are as follows:

Goodwill Broadcast Market Clusters	December 31, 2010	2011	2012
Discount rate	9.0%	9.0%	**9.0%**
Operating profit margin ranges	3.8% - 36.3%	3.8% - 38.0%	**5.1% - 35.5%**
Long-term market revenue growth rate ranges	0.25% - 3.5%	1.0% - 4.0%	**0.3% - 15.0%**

If the carrying amount, including goodwill, exceeds the estimated fair value of the cluster, an indication exists that the amount of goodwill attributed to that cluster may be impaired. When we have indication of impairment, we perform a second step to determine the amount of any impairment. We engaged Bond & Pecaro, an independent third-party appraisal and valuation firm, to determine the enterprise value of three of our markets in a manner similar to a purchase price allocation. The enterprise valuation assumes that the subject assets are installed as part of an operating business rather than as a hypothetical start-up. The key estimates and assumptions used for our enterprise valuations are as follows:

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Enterprise Valuations	December 31, 2012 Broadcast Market Clusters
Discount rate	**9.0%**
Operating profit margin ranges	**16.9% - 49.2%**
Long-term revenue market growth rate ranges	**1.0% - 3.5%**

Based on our review and analysis we determined that no broadcast goodwill impairment charges were necessary as of the annual testing periods ending December 31, 2012, 2011 and 2010. The estimated fair value of our networks exceeded the carrying value by 120.0%, 101.6%, and 98.6% for each of the annual testing periods ending December 31, 2012, 2011 and 2010, respectively.

The tables below present the percentage within a range by which the enterprise value exceeded the carrying value of each of our clusters, including goodwill:

	Broadcast Market Clusters as of December 31, 2012 Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of market clusters	**2**	**1**	**1**	**5**
Enterprise carrying value (in thousands)	**$ 18,836**	**$ 1,423**	**$ 10,506**	**$ 132,645**

	Broadcast Market Clusters as of December 31, 2011 Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of market clusters	1	2	3	2
Enterprise carrying value (in thousands)	$ 9,877	$ 17,487	$ 68,506	$ 5,178

	Broadcast Market Clusters as of December 31, 2010 Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of market clusters	2		2	3
Enterprise carrying value (in thousands)	$ 19,502	$	$ 66,871	$ 7,295

Goodwill Internet & Publishing

During 2012, we adopted ASU 2011-08, Testing Goodwill for Impairment. As a result, beginning in 2012, the first step of the impairment tests for goodwill is a thorough assessment of qualitative factors to determine if events or circumstances indicate that it is not more likely than not that the fair value of these assets is less than their carrying amounts. If the qualitative test indicates it is not more likely than not that the fair value of these assets is less than their carrying amounts, a quantitative assessment is not required. The units of accounting we use to test goodwill in our Internet business include Townhall.com and Salem Web Network. The operating results for Salem Web Network reflect the operating results and cash flows for all of our Internet sites exclusive of Townhall.com. We also separate our publishing business into two accounting units. The first publishing accounting unit is the magazine unit, which operates and produces all publications from a stand-alone facility, under one general manager, with operating results and cash flows of all publications reported on a combined basis. The second accounting unit is our book publishing division, Xulon Press, which also operates from a stand-alone facility, under one general manager who is responsible for the separately stated operating results and cash flows. Four of these accounting units have goodwill associated with them as our annual testing period.

We applied a market approach to estimate the fair value of each or our accounting units. Under the market approach, we applied a multiple of four to each accounting units operating income to estimate the fair value. We believe that a multiple of four is a conservative benchmark based on actual industry transactions. The first step of our review compared the estimated fair value of each accounting unit to its carrying value including goodwill. If the carrying amount, including goodwill, exceeded the estimated fair value of the unit, an indication exists that the amount of goodwill attributed to that unit may be impaired. When we have indication of impairment, we performed a second step to determine the amount of any impairment. We engaged Bond & Pecaro, an independent third-party appraisal and valuation firm, to determine the enterprise value of one of our accounting units in a manner similar to a purchase price allocation. The enterprise valuation assumes that the subject assets are installed as part of an operating business rather than as a hypothetical start-up. The key estimates and assumptions used for our enterprise valuations are as follows:

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Enterprise Valuations	2010	December 31, 2011	2012
Discount rate	8.5%	13.5%	**8.5% - 13.5%**
Operating profit margin ranges	2.0% - 8.4%	18.4% - 22.0%	**0.5% - 22.0%**
Long-term revenue growth rate ranges	2.0%	3.0%	**1.5% - 3.0%**

The key assumptions in our third-party enterprise valuation varied from the testing period ending December 31, 2011 to the testing period ending December 31, 2010 due to the accounting units for which the enterprise valuations were performed. Due to the nature of the business, publishing varies greatly from our print magazines to our online print-on demand digital book publisher and our Internet businesses. The key estimates for 2012 include the ranges applicable to both publishing and our Internet businesses.

Based on our review and analysis we determined that no impairment charges were necessary as of the annual testing periods ending December 31, 2012, 2011 and 2010. The table below presents the percentage within a range by which the enterprise value exceeded the carrying value of our accounting units, including goodwill.

	Internet and Publishing Accounting units as of December 31, 2012 Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of accounting units			**2**	**4**
Enterprise carrying value (in thousands)	**$**	**$**	**$ 28,722**	**$ 2,103**

We believe we have made reasonable estimates and assumptions to calculate the estimated fair value of our indefinite-lived intangible assets, however, these estimates and assumptions could be materially different from actual results. If actual market conditions are less favorable than those projected by the industry or by us, or if events occur or circumstances change that would reduce the estimated fair value of our indefinite-lived intangible assets below the amounts reflected on our balance sheet, we may recognize future impairment charges, the amount of which may be material.

Income taxes and uncertain tax positions

We account for income taxes in accordance with FASB ASC Topic 740 Income Taxes. Upon the adoption of the provisions on January 1, 2007, we had $3.0 million in liabilities related to uncertain tax positions, including $0.9 million recognized under FASB ASC Topic 450 Contingencies and carried forward from prior years and $2.1 million recognized upon adoption of the tax provision changes as a reduction to retained earnings. Included in the $2.1 million accrual was $0.1 million in related interest, net of federal income tax benefits. During 2011, we recognized a net increase of $0.2 million in liabilities and at December 31, 2011, had $3.8 million in liabilities for unrecognized tax benefits. During 2012, we recognized a net decrease of $2.5 million in liabilities and at December 31, 2012, had $1.3 million in liabilities for unrecognized tax benefits. Included in this liability amount were $0.02 million accrued for the related interest, net of federal income tax benefits and $0.02 million for the related penalties recorded in income tax expense on our Consolidated Statements of Operations. Management expects an additional reduction of $0.4 million in the reserve over the next twelve months due to statute expirations.

A summary of the changes in the gross amount of unrecognized tax benefits is as follows:

	December 31, 2012 *(Dollars in thousands)*
Balance at January 1, 2012	$ 3,852
Additions based on tax positions related to the current year	
Additions based on tax positions related to prior years	
Reductions related to tax positions of prior years	
Decrease due to statute expirations	(2,429)
Related interest and penalties, net of federal tax benefits	(98)
Balance as of December 31, 2012	$ 1,325

Valuation allowance (deferred taxes)

For financial reporting purposes, we recorded a valuation allowance of $2.9 million as of December 31, 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.

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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 or 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.

FASB ASC Topic 820 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 December 31, 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.

Long-term debt and debt covenant compliance

Our classification of borrowings under our Revolver as long-term debt on our balance sheet is based on our assessment that, under the terms of our Credit Agreement and after considering our projected operating results and cash flows for the coming year, no principal payments are required to be made. These projections are estimates dependent upon a number of factors including but not limited to developments in the markets in which we are operating in and varying economic and political factors. Accordingly, these projections are inherently uncertain and our actual results could differ from these estimates.

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Stock-Based compensation

We have one stock option plan, The Amended and Restated 1999 Stock Incentive Plan, (the Plan) under which equity awards, including stock options and restricted stock may be granted to employees, consultants and non-employee members of the Board of the Directors of the company. At the annual meeting of the company held on June 22, 2012, the company s stockholders approved a revision to the Plan increasing the number of shares authorized by 1,900,000. As a result, a maximum of 5,000,000 shares are authorized under the Plan, of which 1,927,099 are outstanding and 707,024 are exercisable as of December 31, 2012.

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.

Recent Accounting Pronouncements

In October 2012, the FASB issued ASU 2012-04, Technical Corrections and Improvements. The amendments in this update cover a wide range of Topics in the Accounting Standards Codification. These amendments include technical corrections and improvements to the Accounting Standards Codification and conforming amendments related to fair value measurements. The amendments in this update will be effective for fiscal periods beginning after December 15, 2012. The adoption of ASU 2012-04 is not expected to have a material impact on our financial position, results of operations or cash flows.

In July 2012, the FASB issued 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. We adopted ASU 2012-02 as of our 2012 annual impairment testing performed in the fourth quarter of 2012. Adoption of this pronouncement did not have a material impact on our financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities . 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 2011-11 is not expected to have a material impact on our financial position, results of operations or cash flows.

LIQUIDITY AND CAPITAL RESOURCES

Our focus is to continue to deleverage the company. We have historically financed acquisitions through borrowings, including borrowings under credit facilities and, to a lesser extent, from operating cash flow and from proceeds on selected asset dispositions. We expect to fund any 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 historically funded, and will continue to fund, expenditures for operations, administrative expenses, capital expenditures and debt service required by our credit facilities and the notes from operating cash flow, borrowings under the Revolver and, if necessary, proceeds from the sale of selected assets or radio stations. We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC broadcast licenses, expand our Internet offerings, improve our facilities and update our computer infrastructures. The nature and timing of these upgrades and expenditures can be delayed or scaled back at the discretion of management. We expect to incur capital expenditures of $8.4 million throughout the twelve months ending December 31, 2013.

Cash Flows

Cash and cash equivalents increased $0.3 million to $0.4 million as of December 31, 2012 compared to $0.1 million as of the same period of the prior year. Working capital decreased $8.6 million to $(3.2) million as of December 31, 2012, compared to $5.4 million for the same period of the prior year due to our short-term Subordinated Debt due to Related Parties.

The following events impacted our liquidity and capital resources during the year ended December 31, 2012:

- Capital expenditures increased $1.0 million to $8.5 million from $7.5 million for the same period of the prior year;
- Our Day s Sales Outstanding DSO improved to 66 days as of December 31, 2012 compared to 67 days for the same period of the prior year;
- Cash paid for acquisitions increased $1.5 million to $10.7 million from $9.2 million for the prior year;
- We redeemed $21.5 million of total principal on the $9^5/_8$% Notes at a price equal to 103% of face value, or $22.1 million in cash;
- We increased the balance outstanding on our Revolver by $2.0 million and entered the new FCB Loan that had an outstanding balance of $7.5 million,
- We increased the amount outstanding under our Subordinated Debt due to Related Parties by $6.0 million,
- We paid common stock dividends of $3.4 million cash, or $0.14 per share, during the year ended December 31, 2012; and
- Our income from continuing operations decreased $1.9 million to $4.5 million from $6.4 million for the prior year.

Credit Facilities

The Revolver and the $9^5/_8$% Notes have been entered into by Salem Communications Corporation. Our parent company, Salem Communications Corporation, has no independent assets or operations. All of the subsidiaries of Salem Communications Corporation are currently guarantors of the Revolver and the $9^5/_8$% Notes. The guarantees are full and unconditional and joint and several, and any subsidiaries of the parent company other than the subsidiary guarantors are minor.

On February 25, 2013, we launched a tender offer to purchase for cash any and all of the outstanding $9^5/_8$% Notes and a related consent solicitation (collectively, the Tender Offer) to amend the indenture governing the $9^5/_8$% Notes (the Indenture). In connection with the Tender Offer, we plan to enter into a new senior secured term loan of up to $300 million, which will be used to fund the purchase of any $9^5/_8$% Notes that are tendered in the Tender Offer. We also plan to enter into a new senior secured revolving credit facility of up to $25 million. If the requisite consents have been obtained from holders of the $9^5/_8$% Notes in the Tender Offer, substantially all of the restrictive covenants, certain events of default and other provisions contained in the Indenture governing the $9^5/_8$% Notes will be eliminated and the liens on the assets that secure the $9^5/_8$% Notes will be released, making any $9^5/_8$% Notes that remain outstanding after the consummation of the Tender Offer effectively subordinated to the new term loan and the new revolving credit facility to the extent of the value of the collateral. The proceeds from these facilities will be used to fund the Tender Offer and retire all other outstanding corporate debt. Holders of the $9^5/_8$% Notes who tender by the consent payment deadline, which is 5:00 pm, New York City time, on March 8, 2013, will receive a consent payment as part of the Tender Offer consideration. The Tender Offer is anticipated to expire at midnight, New York City time, on March 22, 2013. Regardless of whether we obtain the requisite consents from holders of the $9^5/_8$% Notes in the Tender Offer, we intend, at our sole discretion and without any obligation to do so, to retire any $9^{5}/_{8}$% Notes that are not tendered in the Tender Offer in accordance with the terms of the Indenture governing the $9^{5}/_{8}$% Notes, which may include redeeming the $9^{5}/_{8}$% Notes. Upon entry into the new term loan and the new revolving credit facility, the Revolver, FCB Loan, and Subordinated Debt due to Related Parties will be terminated.

Senior Credit Facility

On December 1, 2009, our parent company, Salem Communications Corporation entered into 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 $9^{5}/_{8}$% Notes. The calculation of the Available Amount also pertains to the payment of dividends when the leverage ratio is above 5.0 to 1.

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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 the company s discretion without penalty or premium. We believe the borrowing capacity of the Revolver allows us to meet our ongoing operating requirements, fund capital expenditures, and satisfy our debt service requirements. 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. Amounts outstanding under the Revolver may be paid and then reborrowed at Salem s discretion without penalty or premium. At December 31, 2012, the blended interest rate on amounts outstanding under the Revolver was 3.32%.

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 maximum leverage ratio declines over time until December 31, 2014, at which point it is 5.50 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 December 31, 2012, our leverage ratio was 4.87 to 1 and our interest coverage ratio was 2.23 to 1. We were in compliance with our debt covenants under the Revolver at December 31, 2012, and we remain in compliance.

Senior Secured Second Lien Notes

On December 1, 2009, we issued $300.0 million principal amount of $9^5/_8$% 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 $9^5/_8$% Notes that are due in full in December 2016. The $9^5/_8$% 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 $9^5/_8$% Notes. As of December 31, 2011 and 2012, accrued interest on the $9^5/_8$% Notes was $1.0 million and $0.9 million, respectively. The discount is being amortized to interest expense over the term of the $9^5/_8$% Notes based on the effective interest method. For each of the twelve months ended December 31, 2012 and 2011, approximately $0.2 million, respectively, of the discount has been recognized as interest expense.

On December 12, 2012, we redeemed $4.0 million of the $9^5/_8$% Notes for $4.1 million, or at a price equal to 103% of the face value. This transaction resulted in a $0.2 million pre-tax loss on the early retirement of debt, including approximately $17,000 of unamortized discount and $0.1 million of bond issue costs associated with the $9^5/_8$% Notes.

On June 1, 2012, we redeemed $17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

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On December 12, 2011, we redeemed \$12.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On September 6, 2011, we repurchased \$5.0 million of the $9^5/_8$% Notes for \$5.1 million, or at a price equal to $102^7/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On June 1, 2011, we redeemed \$17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

Information regarding repurchases and redemptions of the $9^5/_8$% Notes are as follows:

Date	Principal Redeemed/Repurchased	Premium Paid	Unamortized Discount	Bond Issue Costs
		(Dollars in thousands)		
December 12, 2012	\$ 4,000	\$ 120	\$ 17	\$ 57
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 $9^5/_8$% Notes was \$233.8 million and \$212.6 million at December 31, 2011 and 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 December 31, 2012, the outstanding principal balance on the FCB loan was \$7.5 million with approximately \$23,906 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 December 31, 2012, our leverage ratio was 4.87 to 1 and our interest coverage ratio was 2.23 to 1. We were in compliance with our debt covenants under the FCB Loan at December 31, 2012, and we remain in compliance.

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Subordinated Debt due to Related Parties

On November 17, 2011, we entered into subordinated 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 subordinated 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 subordinated 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 Subordinated Debt due to Related Parties).

The proceeds of the subordinated lines of credit may be used to repurchase a portion of Salem s outstanding $9^5/_8$% Notes. Outstanding amounts under each subordinated 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 subordinated line of credit must be repaid within three (3) months from the time that such amounts are borrowed, with the exception of the subordinated line of credit with Mr. Hinz, which must be repaid within six (6) months from the time that such amounts are borrowed. The subordinated lines of credit do not contain any covenants. At December 31, 2011 and 2012, $9.0 million and $15.0 million, respectively, was outstanding under the Subordinated Debt due to Related Parties.

Because the transactions with Msrs. 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 subordinated lines of credit any definitive credit agreements associated therewith. As part of its consideration, the Committee concluded that the terms of the subordinated lines of credit were more favorable to Salem as compared to terms of lines of credit available from unaffiliated third parties. Additionally, in August 2012, the company obtained a fairness opinion from Bond & Pecaro confirming this conclusion.

Summary of long-term debt obligations

Long-term debt consisted of the following:

	As of December 31,	
	2011	**2012**
	(Dollars in thousands)	
Revolver under senior credit facility	$ 31,000	**$ 33,000**
$9^5/_8$% senior secured second lien notes due 2016	233,846	**212,622**
Subordinated debt		**7,500**
Subordinated debt due to related parties	9,000	**15,000**
Capital leases and other loans	957	**858**
	274,803	**268,980**
Less current portion	(9,124)	**(20,108)**
	$ 265,679	**$ 248,872**

In addition to the amounts listed above, we also have interest payments related to our long-term debt as follows as of December 31, 2012:

Outstanding borrowings of $33.0 million under the Revolver, with interest payments due at LIBOR plus 3.00% or at prime rate plus 1.25%;

$213.5 million $9^5/_8$% Notes with semi-annual interest payments at an annual rate of $9^5/_8$%;

- Outstanding borrowings of $7.5 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.

During the year ended December 31, 2012, the amounts outstanding on our Revolver and FCB loan ranged from $28.0 million to $49.0 million. During the first quarter of 2012, cash flows from operations were used to pay down the Revolver to $36.3 million. During the second quarter of 2012, we increased the amount outstanding under the Revolver and the new FCB loan to $46.6 million,

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during which time we redeemed $17.5 million of the $9^5/_8$% Notes for $18.0 million and paid interest on the $9^5/_8$% Notes of $11.2 million. During the third quarter of 2012, we repaid $8.5 million of the net amount outstanding on the Revolver and FCB loan to $38.1 million while at the same time funding the $1.2 million acquisition of WLCC-AM in Tampa, Florida and SermonSpice for $3.0 million. During the fourth quarter of 2012, the balance outstanding on the Revolver and FCB Loan decreased by a net amount of $2.4 million after funding the acquisition of Godvine for $4.2 million, the $4.0 million redemption of the $9^5/_8$% Notes for $4.1 million and payments of interest on the $9^5/_8$% Notes of $10.5 million.

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 incurred significant impairment losses in prior years with regard to our indefinite-lived intangible assets. During the current year, we recognized impairment losses of $0.1 million associated with mastheads in our publishing segment. This impairment was driven by a reduction in projected net revenues resulting from ongoing operating results that have not met expectations. The impairment was indicative of trends in the publishing industry as a whole and is not unique to our company or operations.

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.

The impairment charges we have recognized are non-cash in nature and did violate covenants on our then-existing credit facilities or Revolver. However, the potential for future impairment charges can be viewed as a negative factor with regard to forecasted future performance and cash flows. We believe that we have adequately considered the economic downturn in our valuation models and do not believe that the non-cash impairments in and of themselves are a liquidity risk.

OFF-BALANCE SHEET ARRANGEMENTS

At December 31, 2011 and 2012, Salem did 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 arrangements or other contractually narrow or limited purposes. As such, Salem is not materially exposed to any financing, liquidity, market or credit risk that could arise if Salem had engaged in such relationships.

CONTRACTUAL OBLIGATIONS

We enter 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 estimated fair value of these arrangements is zero. We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC broadcast licenses, expand our Internet offerings, improve our facilities and update our computer infrastructures. We expect to incur capital expenditures of approximately $8.5 million throughout the twelve months ending December 31, 2013; the nature and timing of these upgrades and expenditures can be delayed or scaled back at the discretion of management.

On February 25, 2013, we launched a tender offer to purchase for cash any and all of the outstanding $9\,^5/_8$% Notes and a related consent solicitation (collectively, the Tender Offer) to amend the indenture governing the $9\,^5/_8$% Notes (the Indenture). In connection with the Tender Offer, we plan to enter into a new senior secured term loan of up to $300 million, which will be used to fund the purchase of any $9\,^5/_8$% Notes that are tendered in the Tender Offer. We also plan to enter into a new senior secured revolving credit facility of up to $25 million. If the requisite consents have been obtained from holders of the $9\,^5/_8$% Notes in the Tender Offer, substantially all of the restrictive covenants, certain events of default and other provisions contained in the Indenture will be eliminated and the liens on the assets that secure the $9\,^5/_8$% Notes will be released, making any $9\,^5/_8$% Notes that remain outstanding after the consummation of the Tender Offer effectively subordinated to the new term loan and the new revolving credit facility to the extent of the value of the collateral. The proceeds from these facilities will be used to fund the Tender Offer and retire all other outstanding corporate debt. Holders of the $9\,^5/_8$% Notes who tender by the consent payment deadline, which is 5:00 pm, New York City time, on March 8, 2013, will receive a consent payment as part of the Tender Offer consideration. The Tender Offer is anticipated to expire at 12:00 midnight, New York City time, on March 22, 2013. Regardless of whether we obtain the requisite consents from holders of the $9\,^5/_8$% Notes in the Tender Offer, we intend, at our sole discretion and without any obligation to do so, to

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retire any 9 $^{5}/_{8}$% Notes that are not tendered in the Tender Offer in accordance with the terms of the Indenture, which may include redeeming the 9 $^{5}/_{8}$% Notes at a redemption price equal to 100.0% of the principal amount of the 9 $^{5}/_{8}$% Notes redeemed plus the Applicable Premium (as defined in the Indenture) as of, and accrued and unpaid interest, if any, to, but not including, the redemption date (the Make Whole Redemption) and/or pursuant to a provision in the Indenture whereby, prior to December 15, 2013, we may redeem up to an aggregate $30.0 million of the 9 $^{5}/_{8}$% Notes in any 12-month period, in connection with up to two redemptions in such 12-month period, at a redemption price of 103.0% of the principal amount thereof, plus accrued and unpaid interest to the redemption date (the 10% Redemption). The first $26.0 million of untendered 9 $^{5}/_{8}$% Notes are expected to be redeemed pursuant to the 10% Redemption on June 1, 2013, the next $4.0 million of untendered 9 $^{5}/_{8}$% Notes are expected to be redeem pursuant to the 10% Redemption on December 12, 2013, and the balance of untendered 9 $^{5}/_{8}$% Notes are expected to be redeemed pursuant to the Make Whole Redemption on the applicable redemption date following the requisite notice. Upon entry into the new term loan and the new revolving credit facility, the Revolver, FCB Loan, and Subordinated Debt due to Related Parties will be terminated.

The following table summarizes our aggregate contractual obligations at December 31, 2012, and the estimated timing and effect that such obligations are expected to have on our liquidity and cash flow in future periods.

Contractual Obligations	Total	Payments Due by Period Less than One year	1-3 years	3-5 years	More Than 5 years
		(Dollars in thousands)			
Long-term debt, including current portion	$ 268,122	$ 20,000	$ 35,500	$ 212,622	$
Interest payments on long-term debt (1)	84,770	21,796	42,263	20,631	80
Capital lease obligations and other loans	858	108	182	146	422
Operating leases	72,440	10,586	19,595	11,883	30,376
On-Air Talent (2)	3,326	2,232	1,040	36	18
Other Contracts (3)	7,838	2,994	4,844		
Total contractual cash obligations	$ 437,354	$ 57,716	$ 103,424	$ 245,318	$ 30,896

(1) Interest payments on long-term debt are based on the outstanding debt and respective interest rates with interest rates on variable-rate debt held constant through maturity at the December 31, 2012 rates. Interest ultimately paid on these obligations will differ based on changes in interest rates for variable-rate debt, as well as any potential repayments or future refinancing. See Note 6 to the accompanying consolidated financial statements for further details.

(2) On-Air talent agreements are typically one to three years in length with various renewal dates. The liability shown is based on agreements in effect as of December 31, 2012. Future payments will vary as the agreements are renewed.

(3) Other contracts consist of purchase commitments and royalty agreements.

ITEM 7A. 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.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

INDEX TO FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

Salem Communications Corporation

We have audited the accompanying consolidated balance sheets of Salem Communications Corporation and subsidiaries (collectively, the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years ended December 31, 2012. Our audits also included the financial statement schedule of the Company listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Salem Communications Corporation and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

SingerLewak LLP

Los Angeles, California

March 1, 2013

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SALEM COMMUNICATIONS CORPORATION

CONSOLIDATED BALANCE SHEETS

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

	December 31, 2011	**2012**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 67	**$ 380**
Restricted cash	110	
Trade accounts receivable (net of allowance for doubtful accounts of $9,300 in 2011 and $8,926 in 2012)	31,001	**32,874**
Other receivables	888	**609**
Prepaid expenses	3,395	**3,277**
Deferred income taxes	6,403	**6,248**
Assets held for sale		**1,964**
Assets of discontinued operations	102	**8**
Total current assets	41,966	**45,360**
Property, plant and equipment (net of accumulated depreciation of $125,708 in 2011 and $135,823 in 2012)	111,222	**99,467**
Broadcast licenses	371,420	**373,720**
Goodwill	20,092	**22,383**
Other indefinite-lived intangible assets	1,961	**1,873**
Amortizable intangible assets (net of accumulated amortization of $22,817 in 2011 and $25,121 in 2012)	6,469	**8,753**
Deferred financing costs	5,489	**4,002**
Notes receivable (net of allowance of $100 in 2011 and $702 in 2012)	1,459	**1,662**
Other assets	1,232	**2,007**
Total assets	$ 561,310	**$ 559,227**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,565	**$ 4,440**
Accrued expenses	5,542	**6,627**
Accrued compensation and related expenses	8,431	**8,668**
Accrued interest	1,127	**1,110**
Deferred revenue	7,521	**7,396**
Income tax payable	205	**175**
Subordinated debt due related parties	9,000	**15,000**
Current portion of long-term debt and capital lease obligations	124	**5,108**
Total current liabilities	36,515	**48,524**
Long-term debt and capital lease obligations, less current portion	265,679	**248,872**
Deferred income taxes	48,077	**47,593**
Deferred revenue	7,962	**8,140**
Other liabilities	29	**29**
Total liabilities	358,262	**353,158**
Commitments and contingencies (Note 9)		
Stockholders Equity:		

Class A common stock, $0.01 par value; authorized 80,000,000 shares; 21,051,305 and 21,312,510 issued and 18,733,655 and 18,994,860 outstanding at December 31, 2011 and 2012, respectively	210	**213**
Class B common stock, $0.01 par value; authorized 20,000,000 shares; 5,553,696 issued and outstanding at December 31, 2011 and 2012	56	**56**
Additional paid-in capital	231,972	**233,974**
Retained earnings	4,816	**5,832**
Treasury stock, at cost (2,317,650 shares at December 31, 2011 and 2012)	(34,006)	**(34,006)**
Total stockholders equity	203,048	**206,069**
Total liabilities and stockholders equity	$ 561,310	**$ 559,227**

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year Ended December 31,		
	2010	2011	**2012**
Net broadcast revenue	$ 174,933	$ 178,731	**$ 183,180**
Net Internet revenue	20,104	27,304	**33,474**
Net publishing revenue	11,421	12,131	**12,525**
Total net revenue	206,458	218,166	**229,179**
Operating expenses:			
Broadcast operating expenses exclusive of depreciation and amortization shown below (including $1,268, $1,297 and $1,357 for the years ended December 31, 2010, 2011 and 2012, respectively, paid to related parties)	110,421	115,482	**120,772**
Internet operating expenses exclusive of depreciation and amortization shown below	16,722	20,889	**25,145**
Publishing operating expenses exclusive of depreciation and amortization shown below	11,226	11,475	**12,288**
Corporate expenses exclusive of depreciation and amortization shown below (including $209, $402 and $386 for the years ended December 31, 2010, 2011 and 2012, respectively, paid to related parties)	16,613	17,503	**18,892**
Depreciation	12,570	12,520	**12,343**
Amortization	2,018	2,451	**2,304**
Impairment of long-lived assets			**6,896**
(Gain) loss on disposal of assets	255	(4,153)	**49**
Total operating expenses	169,825	176,167	**198,689**
Operating income (loss) from continuing operations	36,633	41,999	**30,490**
Other income (expense):			
Interest income	183	344	**106**
Interest expense (including $0, $38 and $427 for the years ended December 31, 2010, 2011 and 2012, respectively, due to related parties)	(30,297)	(27,665)	**(24,911)**
Loss on early retirement of long-term debt	(1,832)	(2,169)	**(1,088)**
Other income (expense), net	(16)	(40)	**79**
Income from continuing operations before income taxes	4,671	12,469	**4,676**
Provision for income taxes	2,695	6,110	**153**
Income from continuing operations	1,976	6,359	**4,523**
Loss from discontinued operations, net of tax	(44)	(741)	**(95)**
Net income	$ 1,932	$ 5,618	**$ 4,428**

See accompanying notes

SALEM COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS (CONTINUED)

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

	Year Ended December 31, 2010	2011	2012
Basic earnings per share data:			
Earnings per share from continuing operations	$ 0.08	$ 0.26	**$ 0.18**
Earnings (loss) per share from discontinued operations		(0.03)	
Basic earnings per share	$ 0.08	$ 0.23	**$ 0.18**
Diluted earnings per share data:			
Earnings per share from continuing operations	$ 0.08	$ 0.26	**$ 0.18**
Earnings (loss) from discontinued operations		(0.03)	
Diluted earnings per share	$ 0.08	$ 0.23	**$ 0.18**
Dividends per share	$ 0.20	$	**$ 0.14**
Basic weighted average shares outstanding	24,086,829	24,475,102	**24,577,605**
Diluted weighted average shares outstanding	24,653,465	24,683,644	**24,986,966**

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Dollars in thousands, except share data)

	Class A Common Stock		Class B Common Stock					
	Shares	Amount	Shares	Amount	Additional Paid-In Capital	Retained Earnings (Loss)	Treasury Stock	Total
Stockholders equity, December 31, 2009	20,437,742	204	5,553,696	56	228,839	2,106	(34,006)	197,199
Stock-based compensation					1,437			1,437
Lapse of restricted shares	5,000							
Options exercised	557,451	5			333			338
Tax benefit related to stock options exercised					338			338
Dividends						(4,840)		(4,840)
Net income						1,932		1,932
Stockholders equity, December 31, 2010	21,000,193	209	5,553,696	56	230,947	(802)	(34,006)	196,404
Stock-based compensation					950			950
Lapse of restricted shares	10,000							
Options exercised	41,112	1			23			24
Tax benefit related to stock options exercised					52			52
Net income						5,618		5,618
Stockholders equity, December 31, 2011	21,051,305	210	5,553,696	56	231,972	4,816	(34,006)	203,048
Stock-based compensation					1,368			1,368
Lapse of restricted shares								
Options exercised	261,205	3			406			409
Tax benefit related to stock options exercised					228			228
Dividends						(3,412)		(3,412)
Net income						4,428		4,428
Stockholders equity, December 31, 2012	**21,312,510**	**213**	**5,553,696**	**56**	**233,974**	**5,832**	**(34,006)**	**206,069**

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SALEM COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31, 2010	2011	**2012**
OPERATING ACTIVITIES			
Income from continuing operations	$ 1,976	$ 6,359	**$ 4,523**
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:			
Non-cash stock-based compensation	1,437	950	**1,368**
Excess tax benefit from stock options exercised	(338)	(52)	**(228)**
Depreciation and amortization	14,588	14,971	**14,647**
Amortization of bond issue costs and bank loan fees	1,639	1,556	**1,291**
Amortization and accretion of financing items	189	186	**179**
Provision for bad debts	2,198	2,069	**2,554**
Deferred income taxes	2,387	5,404	**(101)**
Impairment of long-lived assets			**6,896**
(Gain) loss on disposal of assets	255	(4,153)	**49**
Loss on early retirement of debt	1,832	2,169	**1,088**
Changes in operating assets and liabilities:			
Accounts receivable	(4,407)	(633)	**(2,556)**
Prepaid expenses and other current assets	(175)	(81)	**118**
Accounts payable and accrued expenses	710	980	**3,291**
Deferred revenue	849	(616)	**(2,240)**
Other liabilities	(446)	2,601	
Income taxes payable	123	(5)	**(30)**
Net cash provided by continuing operating activities	22,817	31,705	**30,849**
INVESTING ACTIVITIES			
Capital expenditures	(7,819)	(7,522)	**(8,549)**
Deposits on radio station acquisitions and equipment	(193)	248	**(725)**
Purchases of broadcast assets and radio stations	(3,090)	(3,151)	**(3,330)**
Purchases of Internet businesses and assets	(4,470)	(6,000)	**(7,365)**
Proceeds from the disposal of assets	44	12,750	**907**
Deposit received on pending sale of broadcast business	1,000		
Proceeds from eminent domain	996		
Net cash outflows from related party residential purchase	(155)		
Restricted cash		(10)	**110**
Other	(90)	(826)	**(114)**
Net cash used in investing activities of continuing operations	(13,777)	(4,511)	**(19,066)**
FINANCING ACTIVITIES			
Payments of costs related to bank credit facilities	(319)	(597)	**(149)**
Payments of bond issue costs	(681)	(43)	
Payments of bond premium in connection with early redemption	(900)	(1,044)	**(645)**
Payments to redeem $9^5/_8$% Notes	(30,000)	(35,000)	**(21,500)**
Proceeds from borrowings under credit facilities	54,000	108,400	**154,169**
Payments under credit facilities	(34,000)	(112,400)	**(144,669)**
Proceeds from subordinated debt due to related parties		9,000	**27,000**

Payments to subordinated debt due to related parties			**(21,000)**
Proceeds from exercise of stock options	338	24	**409**
Excess tax benefit from stock options exercised	338	52	**228**
Payment of cash dividend on common stock	(4,840)		**(3,412)**

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(Dollars in thousands)

	Year Ended December 31,		
	2010	2011	**2012**
Payments on capital lease obligations	(86)	(116)	**(125)**
Book overdraft		3,650	**(1,775)**
Net cash used in financing activities	(16,150)	(28,074)	**(11,469)**
CASH FLOWS FROM DISCONTINUED OPERATIONS			
Operating cash flows	(262)	(625)	**(1)**
Investing cash flows	(745)	744	
Total cash inflows (outflows) from discontinued operations	(1,007)	119	**(1)**
Net increase (decrease) in cash and cash equivalents	(8,117)	(761)	**313**
Cash and cash equivalents at beginning of period	8,945	828	**67**
Cash and cash equivalents at end of period	$ 828	$ 67	**$ 380**
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest (including $0, $0 and $322 for the years ended December 31, 2010, 2011 and 2012, respectively, paid to related parties)	29,668	26,053	**23,448**
Income taxes	159	226	**220**
Non-cash investing and financing activities:			
Trade revenue	4,773	5,352	**5,270**
Trade expense	4,514	4,680	**5,309**
Note receivable acquired in exchange for radio station		1,000	
Assets acquired under capital leases	238	25	**27**

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying 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.

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 that 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, SermonSpice.com, GodVine.com and Jesus.org. SWN s content is also accessible through our radio station websites that feature content of interest to local listeners throughout the United States. SWN operates our radio station websites and Salem Consumer Products, a website offering books, DVD s and editorial content developed by many of our on-air radio personalities that are available for purchase. The revenues generated from this segment are reported as Internet revenue on our Consolidated Statements of Operations.

We also operate Salem Publishing , that 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 Consolidated Statements of Operations.

Cash and Cash Equivalents

We consider all highly liquid debt instruments, purchased with an initial maturity of three-months or less, to be cash equivalents. The carrying value of our cash equivalents approximated fair value at each balance sheet date.

Restricted Cash

Restricted cash includes amounts that are contractually restricted in connection with a security agreement between the company and Traveler s Insurance.

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 was to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

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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 is recognized when the products are shipped and the services are rendered. Revenues from the sale of advertising in our magazines is recognized upon publication. Revenue from the sale of subscriptions to our publications is recognized over the life of the subscription. Revenue from book sales is 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 was 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 goods or services received in such barter transactions is charged to expense as used. Barter advertising revenue included in broadcast revenue for the years ended December 31, 2010, 2011 and 2012 was approximately $4.6 million, $5.2 million and $5.3 million, respectively, and barter expenses were approximately the same as barter revenue for each period.

Accounting for Stock-Based Compensation

The company has one employee stock compensation plan, described more fully in Note 11. Stock Option Plan. We account for stock-based compensation in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 718 Compensation Stock Compensation. We record equity awards under the fair value method with share-based compensation measured at the fair value of the award as of the grant date. The exercise price for options is equal to the closing market price of Salem Communications common stock on the date of grant.

We use the straight-line attribution method to recognize share-based compensation costs over the 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. To calculate the excess tax benefits available as of the date of adoption for use in offsetting future tax shortfalls, we followed the alternative transition method discussed in the FASB ASC Topic 718.

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Accounting for Acquisitions and Upgrades of Radio Station and Network Assets

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 radio stations, networks, Internet or 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 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.

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 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 and 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.

Based on operating results that did not meet expectations, we ceased operating Samaritan Fundraising as of December 31, 2011. Samaritan Fundraising, previously included in our Internet operations, was a web-based fundraising products company that operated from a single facility in Fairfax, VA, under the control of one general manager. As a result of our decision to cease operations, the cash flows associated with this entity ceased and we have no continuing involvement in the operations of the entity. We have reported the operating results and net assets of this entity as a discontinued operation for all periods presented.

The markets and entities that we have accounted for as a discontinued operation are explained in more fully in Note 3 Significant Transactions.

Accounting for Property, Plant and Equipment

Property, plant and equipment are recorded at cost less accumulated depreciation. Cost represents the historical cost of acquiring the asset, including the costs necessarily incurred to bring it to the condition and location necessary for its intended use. For assets constructed for our own use, such as towers and buildings that are discrete projects for which costs are separately accumulated and for which construction takes considerable time, we record capitalized interest. The amount capitalized is the cost that could have been avoided had the asset not been constructed and is based on the average accumulated expenditures incurred over the capitalization period at the weighted average rate applicable to our outstanding variable rate debt. We capitalized interest of $0.1 million during the years ended December 31, 2011 and 2012, respectively. Repair and maintenance costs are charged to expense as incurred. Improvements are capitalized when they extend the life of the asset or enhance the quality or ability of the asset to benefit operations. Depreciation is computed using the straight-line method over estimated useful lives as follows:

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Category	**Life**
Buildings	40 years
Office furnishings and equipment	5-10 years
Antennae, towers and transmitting equipment	20 years
Studio and production equipment	7-10 years
Computer software and website development costs	3 years
Record and tape libraries	3 years
Automobiles	5 years
Leasehold improvements	Lesser of 15 years or life of lease

The carrying value of property, plant and equipment is evaluated periodically in relation to the operating performance and anticipated future cash flows of the underlying radio stations and businesses for indicators of impairment. When indicators of impairment are present and the cash flows estimated to be generated from these assets is less than the carrying value of these assets, an adjustment to reduce the carrying value to the fair market value of the assets is recorded, if necessary. No adjustments to the carrying amounts of property, plant and equipment were made during the years ended December 31, 2010 and 2011.

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 based on the estimated sale price. In December 2012, after several purchase offers for the land were terminated, we obtained a third party valuation for the land. Based on this fair value appraisal, we recorded an additional $1.2 million impairment charge associated with the land.

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

		Fair Value Measurements Using: *(Dollars in thousands)*			
Description	As of December 31, 2012	Quoted prices in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Long-Lived Asset Held for Sale	$ 1,700			$ 1,700	$ 6,808

Accounting for Internally Developed Software and Website Development Costs

We capitalize costs incurred during the application development stage related to the development of internal-use software as specified in FASB ASC Topic 350-40 Internal-Use Software. Capitalized costs are generally amortized over the estimated useful life of three years. Costs incurred related to the conceptual design and maintenance of internal-use software are expensed as incurred. Website development activities include planning, design and development of graphics and content for new websites and operation of existing sites. Costs incurred that involve providing additional functions and features to the website are capitalized. Costs associated with website planning, maintenance, content development and training are expensed as incurred. Capitalized costs are generally amortized over the estimated useful life of three years. We capitalized $2.7 million, $2.3 million and $2.3 million during the years ended December 31, 2010, 2011 and 2012, respectively, related to internally developed software and website development costs. Amortization expense of amounts capitalized was $1.4 million, $1.8 million and $2.1 million for the years ended December 31, 2010, 2011 and 2012, respectively.

Accounting for Advertising and Promotional Cost

Costs of media advertising and associated production costs are expensed as incurred and amounted to approximately $8.6 million, $10.3 million and $10.5 million for each of the years ending December 31, 2010, 2011, and 2012, respectively.

Accounting for Amortizable Intangible Assets

Intangible assets are recorded at cost less accumulated amortization. Typically, intangible assets are acquired in conjunction with the acquisition of radio stations, Internet businesses and publishing entities. These intangibles are amortized using the straight-line method over the following estimated useful lives:

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Category	Life
Customer lists and contracts	Lesser of 5 years or life of contract
Favorable and assigned leases	Life of the lease
Domain and brand names	5 years
Internally developed software	3 to 5 years
Customer relationships	1 to 3 years
Other amortizable intangible assets	5 to 10 years

The carrying value of our amortizable intangible assets are evaluated periodically in relation to the operating performance and anticipated future cash flows of the underlying radio stations and businesses for indicators of impairment. In accordance with FASB ASC Topic 360 Property, Plant and Equipment, when indicators of impairment are present and the undiscounted cash flows estimated to be generated from these assets are less than the carrying amounts of these assets, an adjustment to reduce the carrying value to the fair market value of these assets is recorded, if necessary. No adjustments to the carrying amounts of our amortizable intangible assets were necessary during the years ended December 31, 2010, 2011 or 2012.

Goodwill and Other Indefinite-Lived Intangible Assets

Approximately 71% of our total assets as of December 31, 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 7 to our Consolidated Financial Statements. Please refer to Note 2 Impairment of Goodwill and Other Indefinite-Lived Intangible Assets for a further discussion of our testing plan and impairments recognized.

Gain or Loss on Disposal of Assets

We record gains or losses on the disposal of assets equal to the proceeds, if any, compared to the net book value. Exchange transactions are accounted for in accordance with FASB ASC Topic 845 Non-Monetary Transactions. For the year ended December 31, 2010, we recorded a loss on disposal of assets of $0.3 million which includes a $0.2 million pre-tax loss pending the sale of WAMD-AM, Aberdeen, Maryland, that closed on March 1, 2011, a $0.2 million loss on a related party real estate transaction and $0.2 million of losses related to various other fixed assets and equipment disposals offset by a $0.3 million pre-tax gain associated with the seizure of our property by the Dallas County School District. For the year ended December 31, 2011, we recorded a gain on disposal of assets of $4.2 million that 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, offset by various fixed asset and equipment disposals. For the year ended December 31, 2012, we recorded a $0.2 million pre-tax gain on the sale of WBZS-AM in Pawtucket, Rhode Island and a $0.6 million gain from insurance proceeds for repairs of storm damage in our New York market , 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.

Leases

We lease various facilities including broadcast tower and transmitter sites. When we enter a lease agreement, we review the terms to determine the appropriate classification of the lease as a capital lease or operating lease based on the factors listed in FASB ASC Topic 840 Leases. Our current lease terms generally range from one to twenty-five years with rent expense recorded on a

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straight-line basis for financial reporting purposes. We also sublease towers that we own under various agreements with other broadcasters. Subleases generally cover a sixty-year term, over which time we recognize rental income on a straight-line basis. Deferred rent revenue was $4.7 million and $4.6 million at December 31, 2011 and 2012, respectively.

Leasehold Improvements

We may elect to construct or otherwise invest in leasehold improvements to properties. We capitalize the cost of the improvements that are then amortized over the shorter of the useful life of the improvement or the remaining lease term.

Deferred Financing Costs

Deferred financing costs consist of bond issue costs and bank loan fees. Bond issue costs represent costs incurred in conjunction with the issuance of the $9^5/_8$% Senior Secured Second Lien Notes on December 1, 2009 ($9^5/_8$% Notes). The costs are being amortized over the term of the $9^5/_8$% Notes as an adjustment to interest expense. Bank loan fees represent costs incurred with the Senior Credit Facility, which is a revolving credit facility (Revolver) entered on December 1, 2009. The costs are being amortized over the three-year term of the Revolver as an adjustment to interest expense. During the year ended December 31, 2010, approximately $0.7 million of bond issue costs were written off in conjunction with the early redemption of $30.0 million of the $9^5/_8$% Notes. During the year ended December 31, 2011, approximately $0.1 million of bond issue costs were written off upon the calling and retirement of the $9^5/_8$% Notes. During the year ended December 31, 2012, approximately $0.3 million of bond issue costs were written off upon the calling and retirement of the $9^5/_8$% Notes. Deferred financing costs consist of the following:

	As of December 31, 2011	As of December 31, 2012
	(Dollars in thousands)	
Bond issue costs	$ 4,219	**$ 3,060**
Bank loan fees	1,270	**942**
	$ 5,489	**$ 4,002**

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 adjust our future reserves. Our self-insurance liability was $0.6 million at December 31, 2011 and 2012, respectively.

Local Programming and Marketing Agreement Fees

We may enter into a Local Marketing Agreement (LMA) or Time Brokerage Agreement (TBA) in connection with acquisitions of radio stations that are pending FCC regulatory approval of transfer of the broadcast licenses. Under the terms of these agreements, we make specified periodic payments to the owner in exchange for the right to program and sell advertising for a specified portion of the station s inventory of broadcast time. We record revenues and expenses associated with the portion of the station s inventory of broadcast time it manages. Nevertheless, as the holder of the FCC license, the owner-operator retains control and responsibility for the operation of the station, including responsibility over all programming broadcast on the station. We also enter into LMA s in connection with dispositions of radio stations. In such cases, we may receive periodic payments in exchange for allowing the buyer to program and sell advertising for a portion of the station s inventory of broadcast time.

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 may 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.

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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.

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 7 Fair Value Accounting for a further discussion.

Long-term Debt and Debt Covenant Compliance

Our classification of borrowings under our Revolver as long-term debt on our balance sheet is based on our assessment that, under the terms of our Credit Agreement and after considering our projected operating results and cash flows for the coming year, no principal payments are required to be made. These projections are estimates dependent upon a number of factors including developments in the markets in which we are operating in and economic and political factors, among other factors. Accordingly, these projections are inherently uncertain and our actual results could differ from these estimates.

Income taxes and uncertain tax positions

We account for income taxes in accordance with FASB ASC Topic 740 Income Taxes. Upon the adoption of the provisions on January 1, 2007, we had $3.0 million in liabilities related to uncertain tax positions, including $0.9 million recognized under FASB ASC Topic 450 Contingencies and carried forward from prior years and $2.1 million recognized upon adoption of the tax provision changes as a reduction to retained earnings. Included in the $2.1 million accrual was $0.1 million in related interest, net of federal income tax benefits. During 2011, we recognized a net increase of $0.2 million in liabilities and at December 31, 2011, had $3.8 million in liabilities for unrecognized tax benefits. During 2012, we recognized a net decrease of $2.5 million in liabilities and at December 31, 2012, had $1.3 million in liabilities for unrecognized tax benefits. Included in this liability amount were $0.02 million accrued for the related interest, net of federal income tax benefits and $0.02 million for the related penalties recorded in income tax expense on our Consolidated Statements of Operations. Management expects an additional reduction of $0.4 million in the reserve over the next twelve months due to statute expirations.

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A summary of the changes in the gross amount of unrecognized tax benefits is as follows:

		December 31, 2012
		(Dollars in thousands)
Balance at January 1, 2012	$	3,852
Additions based on tax positions related to the current year		
Additions based on tax positions related to prior years		
Reductions related to tax positions of prior years		
Decrease due to statute expirations		(2,429)
Related interest and penalties, net of federal tax benefits		(98)
Balance as of December 31, 2012	$	1,325

Valuation allowance (deferred taxes)

For financial reporting purposes, we recorded a valuation allowance of $2.9 million as of December 31, 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.

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 1,151,998, 1,640,392 and 1,927,099 shares of Class A common stock were outstanding at December 31, 2010, 2011 and 2012, respectively. Unvested restricted stock shares of 10,000 were outstanding as of December 31, 2010. 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. The number of anti-dilutive shares as of December 31, 2010, 2011 and 2012 was 860,449, 1,397,538 and 480,825, respectively.

The following table sets forth the shares used to compute basic and diluted net earnings per share for the periods indicated:

	Year Ended December 31,		
	2010	2011	**2012**
Weighted average shares	24,086,829	24,475,102	**24,577,605**
Effect of dilutive securities - stock options	566,636	208,542	**409,361**
Weighted average shares adjusted for dilutive securities	24,653,465	24,683,644	**24,986,966**

Segments

We have historically had one reportable operating segment radio broadcasting. Our radio-broadcasting segment operates radio stations throughout the United States, various radio networks and our National sales group. Beginning with the first quarter of 2011, we separated our non-broadcast segment into two operating segments, Internet and Publishing. We believe that this information regarding our non-broadcast segment is useful to readers of our financial statements. Additionally, due to growth within our Internet operations, including the acquisition of WorshipHouseMedia.com on March 28, 2011, our Internet segment qualifies for disclosure as a reportable segment. All prior periods presented have been updated to reflect the separation of these non-broadcast segments. 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. We present our segment operating results in Note 15 to our consolidated financial statements.

Variable Interest Entities

We account for entities qualifying as variable interest entities (VIEs) in accordance with 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 LMA s contemporaneously with entering an 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.

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 December 31, 2012.

Concentrations of Business Risks

We derive a substantial part of our total revenues from the sale of advertising. For the years ended December 31, 2010, 2011 and 2012, 43.3%, 43.0% and 42.3% of our total revenues, respectively, were generated from the sale of broadcast advertising. We are particularly dependent on revenue from stations in the Los Angeles and Dallas markets, which generated 15.8%, and 18.8%, respectively, of our total net advertising revenues for the year ended December 31, 2010, 15.2% and 23.2% for the year ended December 31, 2011 and 16.2% and 23.6% for the year ended December 31, 2012. Because substantial portions of our revenues are derived from local advertisers in these key markets, our ability to generate revenues in those markets could be adversely affected by local or regional economic downturns.

Concentrations of Credit Risks

Our credit risk is spread across a large number of customers, none of which account for a significant volume of revenue or outstanding receivables. We do not normally require collateral on credit sales; however, credit histories are reviewed before extending substantial credit to any customer. We establish an allowance for doubtful accounts based on customers payment history and perceived credit risks. Bad debt expense has been within management s expectations.

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 and goodwill; (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.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications include the separation of our non-broadcast segment into two operating segments, Internet and Publishing. We believe that this information regarding our non-broadcast segments is useful to readers of our financial statements. Additionally, due to growth within our Internet operations, including the acquisition of WorshipHouseMedia as discussed in Note 3, our Internet segment qualifies for disclosure as a reportable segment. All prior periods presented have been updated to reflect the separation of these non-broadcast segments. These reclassifications also include the accounting for discontinued operations as described in more detail in Note 3 to our consolidated financial statements.

Recent Accounting Pronouncements

In October 2012, the FASB issued Accounting Standards Update (ASU) 2012-04, Technical Corrections and Improvements. The amendments in this update cover a wide range of Topics in the Accounting Standards Codification. These amendments include technical corrections and improvements to the Accounting Standards Codification and conforming amendments related to fair value measurements. The amendments in this update will be effective for fiscal periods beginning after December 15, 2012. The adoption of ASU 2012-04 is not expected to have a material impact on our financial position, results of operations or cash flows.

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In July 2012, the FASB issued 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. We adopted ASU 2012-02 as of our 2012 annual impairment testing performed in the fourth quarter of 2012. Adoption of this pronouncement did not have a material impact on our financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. 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 2011-11 is not expected to have a material impact on our financial position, results of operations or cash flows.

NOTE 2. IMPAIRMENT OF GOODWILL AND OTHER INDEFINITE-LIVED INTANGIBLE ASSETS

We account for goodwill and other indefinite-lived intangible assets in accordance with 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.

Approximately 71% of our total assets as of December 31, 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 are 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 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 7 to our Consolidated Financial Statements.

Broadcast Licenses

The unit of accounting we use to test broadcast licenses is the cluster level, which we define as a group of radio stations operating in the same geographic market, sharing the same building and 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.

In July 2012, the FASB issued ASU 2012-02, Intangibles Goodwill and Other (Topic 350). Under ASU 2012-02, we have the option to assess whether it is more likely than not that an indefinite-lived intangible asset is impaired. If it is more likely than not that impairment exists, we are required to perform a quantitative analysis to estimate the fair value of the assets. The qualitative assessment requires significant judgment in considering events and circumstances that may affect the estimated fair value of our broadcast licenses and to weigh the events and circumstances by what we believe to be the strongest to weakest indicator of potential impairment. ASU 2012-02 is effective for annual and interim impairment tests for fiscal years beginning after September 15, 2012, with early adoption permitted. We adopted the provisions of ASU 2012-02 as of our 2012 annual testing period. During 2011 and prior years, we applied the start-up income approach to estimate the fair value of each of our broadcast licenses.

We reviewed the significant assumptions in our most recent fair value estimates that were completed during our annual testing period ending December 31, 2011. Our review included an assessment to determine if events and circumstances have occurred that could affect the significant inputs used in these fair value estimates. Our 2011 fair value calculations were prepared using the start-up income approach to estimate the fair value of the broadcast license. The start-up-income approach measures the expected future economic benefits that the broadcast licenses provide and discounts these future benefits using a discounted cash flow analysis. The discounted cash flow analysis assumes that the broadcast licenses hypothetical start-up stations and the values yielded by the discounted cash flow analysis represent the portion of the stations value attributable solely to the broadcast license. The discounted cash flow model incorporates variables such as projected revenues, operating profit margins, forecasted growth rates, estimated start-up costs, losses expected to be incurred in the early years, competition within the market, the effective tax rate, future terminal values and the risk-adjusted discount rate. The variables used reflect historical company growth trends, industry projections, and the anticipated performance of the business. The discounted cash flow projection period was determined to be ten years; which is typically the time radio station operators and investors expect to recover their investments as widely used by industry analysts in their forecasts.

The key estimates and assumptions used in the start-up income valuation for all of our broadcast licenses were as follows:

Broadcast Licenses	**December 31, 2011**
Discount rate	**9.0%**
Operating profit margin ranges	**3.8% - 38.0%**
Long-term market revenue growth rate ranges	**1.0% - 4.0%**

We reviewed each of the key estimates and assumptions and determined that there have been no significant changes that would need to be applied to a hypothetical start-up station in order to estimate the fair value. Projected revenues, operating profit margins, forecasted growth rates, estimated start-up costs, losses expected to be incurred in the early years, competition within the market, the effective tax rate, future terminal values and the risk-adjusted discount rate are consistent with those applied in the 2011 testing period. We also reviewed internal benchmarks and economic performance for each of our markets to conclude that we could reasonably rely upon the 2011 fair value estimates and assumptions as a starting point to our qualitative analysis.

We calculated the amount by which the 2011 estimated fair values exceeded our carrying amounts to calculate the excess of fair value. We concluded that markets with broadcast licenses with a 25% or more excess of the estimated fair value over the carrying value were not likely to be impaired. We believe based on our analysis and review, including the financial performance of each market, that a 25% excess fair value margin is conservative and reasonable in the qualitative analysis.

The tables below present the percentage within a range by which the estimated fair value exceeded the carrying value of our broadcasting licenses for each of our clusters:

	Geographic Clusters as of December 31, 2012 Percentage Range By Which Fair Value Exceeds Carrying Value			
	£25%	>26-30%	>30% to 75%	> than 75%
Number of market clusters	**12**	**2**	**6**	**9**
Broadcast license carrying value (in thousands)	**$ 248,939**	**$ 22,112**	**$ 26,586**	**$ 76,082**

We considered the 12 markets with an excess fair value that was less than 25% of the carrying values to be more likely than not impaired. For these markets, we engaged Bond & Pecaro, an independent third-party appraisal and valuation firm to perform a quantitative appraisal of our broadcast licenses. Bond & Pecaro utilized the start-up income approach to value broadcast licenses. The key estimates and assumptions used in the Bond & Pecaro start-up income valuation for these selected markets were as follows:

Broadcast Licenses	December 31, 2012
Discount rate	9.0%
Operating profit margin ranges	5.1% - 35.5%
Long-term market revenue growth rate ranges	0.3% - 15.0%

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The table below presents the results of our quantitative analysis for the annual testing period ending December 31, 2012:

Market Cluster	Excess Fair Value 2011 Estimate	Excess Fair Value 2012 Estimate
Atlanta, GA	13.34%	7.54%
Chicago, IL	11.85%	6.38%
Cleveland, OH	9.03%	2.23%
Dallas, TX	7.83%	10.38%
Detroit, MI	10.17%	4.69%
Louisville, KY	24.08%	7.21%
Miami FL	14.93%	27.84%
Omaha, NE	14.36%	8.82%
Orlando, FL	19.36%	38.74%
Portland, OR	19.47%	11.00%
Sacramento, CA	10.46%	4.87%
Tampa, FL	16.17%	44.76%

Based on our review and analysis we determined that no impairment charges were necessary to the carrying value of our broadcast licenses as of the annual testing periods ending December 31, 2012. Based on prior tests, we determined that no impairments of our broadcast licenses were necessary for years ending December 31, 2011 or 2010, respectively.

Mastheads

Mastheads consist of the graphic elements that identify our publications to readers and advertisers. These include customized typeset page headers, section headers, and column graphics as well as other name and identity stylized elements within the body of each publication. We test the value of mastheads as a single combined publishing entity as our print magazines operate from one shared facility under one general manager with operating results and cash flows reported on a combined basis for all publications.

Based on actual operating results as of our year end testing period that did not meet or exceed our expectations, we performed a quantitative review of mastheads as of our annual testing period ending December 31, 2012. We had also performed an interim valuation of mastheads as of June 30, 2012 in which our excess fair value was estimated to be only 1.7%. We engaged Bond & Pecaro, an independent third-party appraisal firm, to perform an income-based approach to determine the estimated fair value of our mastheads. The income approach is based upon an estimated royalty stream that measures a cost savings to the business because it does not have to pay a royalty to use the owned trade name and content. The analysis assumes that the assets are employed by a typical market participant in their highest and best use. Under the income approach, we utilize a discounted cash flow method to calculate the estimated fair value of our mastheads, the key estimates and assumptions to which are as follows:

Mastheads	**December 31, 2010**	**December 31, 2011**	**Interim June 30, 2012**	**December 31, 2012**
Discount rate	8.5%	8.5%	8.5%	**8.5%**
Projected revenue growth ranges	2.0% - 2.5%	1.5% - 2.50%	1.5% - 2.50%	**1.5% - 3.0%**
Royalty growth rate	3.0%	3.0%	3.0%	**3.0%**

We recognized an impairment charge of $0.1 million associated with the value of mastheads in our publishing segment as of the annual testing period ending December 31, 2012. This impairment was driven by a reduction in projected net revenues resulting from ongoing operating results that have not met expectations. The impairment was indicative of trends in the publishing industry as a whole and is not unique to our company or operations.

Goodwill - Broadcast

During 2012, we adopted ASU 2011-08, Testing Goodwill for Impairment. As a result, beginning in 2012, the first step of the impairment tests for goodwill is a thorough assessment of qualitative factors to determine if events or circumstances indicate that it is not more likely than not that the fair value of these assets is less than their carrying amounts. If the qualitative test indicates it is not more likely than not that the fair value of these assets is less than their carrying amounts, a quantitative assessment is not required. The unit of accounting used to test broadcast licenses is the cluster level, which we define as a group of radio stations

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operating in the same geographic market, sharing the same building and equipment and managed by a single general manager. Nine of our 31 market clusters and our networks have goodwill associated with them as of our annual testing period ending December 31, 2012.

The first step of our review included an assessment to determine if events and circumstances have occurred that could affect the significant inputs used in our fair value estimates. We estimated fair values using a market and income approach and compared the estimated fair value of each cluster to its carrying value including goodwill. Using a market approach, we applied a multiple of four to each clusters station operating income (SOI) to calculate the estimated fair value. Radio stations are often sold on the basis of a multiple of projected cash flow, or SOI. Numerous trade organizations and analysts track these radio transactions. Based on reports and analysis of these transactions, we believe industry benchmarks to be in the six to seven times cash flow range. Based our analysis, we determined that an SOI benchmark of four would be a conservative indicator of fair value. Under the income approach, we utilized a discounted cash flow method to calculate the estimated fair value of the accounting unit. The discounted cash flow method incorporates the cumulative present value of the net after-tax cash flows projected for each market assuming that it is a hypothetical start-up station. The key estimates and assumptions used in the start-up income valuation of our broadcast markets for each testing period are as follows:

Goodwill Broadcast Market Clusters	December 31, 2010	December 31, 2011	December 31, 2012
Discount rate	9.0%	9.0%	**9.0%**
Operating profit margin ranges	3.8% - 36.3%	3.8% - 38.0%	**5.1% - 35.5%**
Long-term market revenue growth rate ranges	0.25% - 3.5%	1.0% - 4.0%	**0.3% - 15.0%**

If the carrying amount, including goodwill, exceeds the estimated fair value of the cluster, an indication exists that the amount of goodwill attributed to that cluster may be impaired. When we have indication of impairment, we perform a second step to determine the amount of any impairment. We engaged Bond & Pecaro, an independent third-party appraisal and valuation firm, to determine the enterprise value of three of our markets in a manner similar to a purchase price allocation. The enterprise valuation assumes that the subject assets are installed as part of an operating business rather than as a hypothetical start-up. The key estimates and assumptions used for our enterprise valuations are as follows:

Enterprise Valuations	December 31, 2012 Broadcast Market Clusters
Discount rate	**9.0%**
Operating profit margin ranges	**16.9% - 49.2%**
Long-term revenue market growth rate ranges	**1.0% - 3.5%**

Based on our review and analysis we determined that no broadcast goodwill impairment charges were necessary as of the annual testing periods ending December 31, 2012, 2011 and 2010. The estimated fair value of our networks exceeded the carrying value by 120.0%, 101.6%, and 98.6% for each of the annual testing periods ending December 31, 2012, 2011 and 2010, respectively.

The tables below present the percentage within a range by which the enterprise value exceeded the carrying value of each of our clusters, including goodwill:

	Broadcast Market Clusters as of December 31, 2012			
	Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of market clusters	**2**	**1**	**1**	**5**
Enterprise carrying value (in thousands)	**$ 18,836**	**$ 1,423**	**$ 10,506**	**$ 132,645**

	Broadcast Market Clusters as of December 31, 2011			
	Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of market clusters	1	2	3	2
Enterprise carrying value (in thousands)	$ 9,877	$ 17,487	$ 68,506	$ 5,178

	Broadcast Market Clusters as of December 31, 2010 — Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of market clusters	2		2	3
Enterprise carrying value (in thousands)	$ 19,502	$	$ 66,871	$ 7,295

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Goodwill Internet & Publishing

During 2012, we adopted ASU 2011-08, Testing Goodwill for Impairment. As a result, beginning in 2012, the first step of the impairment tests for goodwill is a thorough assessment of qualitative factors to determine if events or circumstances indicate that it is not more likely than not that the fair value of these assets is less than their carrying amounts. If the qualitative test indicates it is not more likely than not that the fair value of these assets is less than their carrying amounts, a quantitative assessment is not required. The units of accounting we use to test goodwill in our Internet business include Townhall.com and Salem Web Network. The operating results for Salem Web Network reflect the operating results and cash flows for all of our Internet sites exclusive of Townhall.com. We also separate our publishing business into two accounting units. The first publishing accounting unit is the magazine unit, which operates and produces all publications from a stand-alone facility, under one general manager, with operating results and cash flows of all publications reported on a combined basis. The second accounting unit is our book publishing division, Xulon Press, which also operates from a stand-alone facility, under one general manager who is responsible for the separately stated operating results and cash flows. Four of these accounting units have goodwill associated with them as our annual testing period.

We applied a market approach to estimate the fair value of each or our accounting units. Under the market approach, we applied a multiple of four to each accounting units operating income to estimate the fair value. We believe that a multiple of four is a conservative benchmark based on actual industry transactions. The first step of our review compared the estimated fair value of each accounting unit to its carrying value including goodwill. If the carrying amount, including goodwill, exceeded the estimated fair value of the unit, an indication exists that the amount of goodwill attributed to that unit may be impaired. When we have indication of impairment, we performed a second step to determine the amount of any impairment. We engaged Bond & Pecaro, an independent third-party appraisal and valuation firm, to determine the enterprise value of one of our accounting units in a manner similar to a purchase price allocation. The enterprise valuation assumes that the subject assets are installed as part of an operating business rather than as a hypothetical start-up. The key estimates and assumptions used for our enterprise valuations are as follows:

		December 31,	
Enterprise Valuations	**2010**	**2011**	**2012**
Discount rate	8.5%	13.5%	**8.5% - 13.5%**
Operating profit margin ranges	2.0% - 8.4%	18.4% - 22.0%	**0.5% - 22.0%**
Long-term revenue growth rate ranges	2.0%	3.0%	**1.5% - 3.0%**

The key assumptions in our third-party enterprise valuation varied from the testing period ending December 31, 2011 to the testing period ending December 31, 2010 due to the accounting units for which the enterprise valuations were performed. Due to the nature of the business, publishing varies greatly from our print magazines to our online print-on demand digital book publisher and our Internet businesses. The key estimates for 2012 include the ranges applicable to both publishing and our Internet businesses.

Based on our review and analysis we determined that no impairment charges were necessary as of the annual testing periods ending December 31, 2012, 2011 and 2010. The table below presents the percentage within a range by which the enterprise value exceeded the carrying value of our accounting units, including goodwill.

	Internet and Publishing Accounting units as of December 31, 2012 Percentage Range By Which Enterprise Value Exceeds Carrying Value Including Goodwill			
	< 10%	>10% to 20%	>20% to 50%	> than 50%
Number of accounting units			**2**	**4**
Enterprise carrying value (in thousands)	**$**	**$**	**$ 28,722**	**$ 2,103**

We believe we have made reasonable estimates and assumptions to calculate the estimated fair value of our indefinite-lived intangible assets, however, these estimates and assumptions could be materially different from actual results. If actual market conditions are less favorable than those projected by the industry or by us, or if events occur or circumstances change that would reduce the estimated fair value of our indefinite-lived intangible assets below the amounts reflected on our balance sheet, we may recognize future impairment charges, the amount of which may be material.

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NOTE 3. SIGNIFICANT TRANSACTIONS

On December 12, 2012, we redeemed \$4.0 million of the $9^{5}/_{8}$% Notes for \$4.1 million, or at a price equal to 103% of the face value. This transaction resulted in a \$0.2 million pre-tax loss on the early retirement of debt, including approximately \$17,000 of unamortized discount and \$0.1 million of bond issue costs associated with the $9^{5}/_{8}$% Notes.

On December 3, 2012, we began operating radio station WMUU-FM, Greenville, South Carolina under an LMA with the owner. We have agreed to acquire the radio station for \$6.0 million. The \$6.0 million purchase price consists 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 acquisition of this radio station closed on February 5, 2013. Effective February 11, 2013, we changed the call letters of this station to WGTK-FM.

On November 1, 2012, we began operating radio station WJKR-FM, Columbus, Ohio under an LMA with the owner. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the LMA date. The acquisition of this radio station closed on February 15, 2013. Effective February 15, 2013, we changed the call letters of this station to WTOH-FM.

On October 1, 2012, we completed the acquisition of Godvine.com for \$4.2 million. Godvine is a Christian video website and media platform that increases our online presence and offers significant exposure on Facebook with over 2.8 million Facebook fans. We believe that the addition of Godvine.com makes Salem Web Network the largest online destination for Christian content with an average of 5.8 million unique visits per month.

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. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition 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 attributable to the organizational systems and procedures already in place to ensure effective operations of the business.

On June 1, 2012, we redeemed \$17.5 million of the $9^{5}/_{8}$% 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 issue costs associated with the $9^{5}/_{8}$% 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 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 December 31, 2012, \$7.5 million was outstanding on the FCB Loan.

On May 21, 2012, we entered into an additional subordinated 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 subordinated 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, 2012, \$15.0 million was outstanding on all of our Subordinated Debt due to Related Parties, including amounts due Mr. Epperson.

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. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition 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 Consolidated Statements of Operations reflect the operating results of this entity through the date of the sale.

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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 $0.035 per share, were paid on March 30, 2012, June 29, 2012, September 28, 2012 and December 28, 2012, respectively, to all common stockholders of record. We paid $3.4 million in dividends during 2012. 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 previous owner on November 1, 2011. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the TBA date. The accompanying 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 year ended December 31, 2012, none of which were individually or in aggregate material to our consolidated financial position as of the respective date of acquisition, is as follows:

Acquisition Date	Description	Total Cost
		(Dollars in thousands)
October 1, 2012	Godvine.com (business acquisition)	$ 4,200
August 31, 2012	WLCC-AM, Tampa, Florida (business acquisition)	1,150
August 30, 2012	Sermonspice.com (business acquisition)	3,000
May 15, 2012	Churchangel.com and rchurch.com (asset purchase)	165
April 10, 2012	WKDL-AM, Warrenton, Virginia (business acquisition)	30
January 13, 2012	KTNO-AM, Dallas, Texas (business acquisition)	2,150
		$ 10,695

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 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:

	Broadcast Assets Acquired	Internet Assets Acquired	Net Assets Acquired
		(Dollars in thousands)	
Asset			
Property and equipment	$ 2,235	$ 289	$ 2,524
Broadcast licenses	1,086		1,086
Goodwill	9	2,283	2,292
Customer lists and contracts		767	767
Software		309	309
Customer relationships		927	927
Domain and brand names		2,711	2,711
Non-compete		106	106
Liabilities			
Subscriber liabilities assumed		(27)	(27)
	$ 3,330	$ 7,365	$ 10,695

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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 were no material cash flows associated with this entity and we have no ongoing or further involvement in the operations of this entity. The Consolidated Balance Sheets and Statements of Operations for all prior periods presented have been updated to reflect the operating results and net assets of this entity as a discontinued operation. As of December 31, 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:

	Year Ended December 31,		
	2010	**2011**	**2012**
	(Dollars in thousands)		
Net revenues	$ 464	$ 1,950	**$ 38**
Operating expenses	536	2,793	**196**
Operating loss	$ (72)	$ (843)	**$ (158)**
Impairment of assets used in discontinued operations		(382)	
Loss from discontinued operations	$ (72)	$ (1,225)	**$ (158)**
Benefit from income taxes	(28)	(484)	**(63)**
Loss from discontinued operations, net of tax	$ (44)	$ (741)	**$ 95**

A summary of our business acquisitions for the year ended December 31, 2011, none of which were individually or in aggregate material to our consolidated financial position as of the respective date of acquisition, is as follows:

Acquisition Date	**Description**	**Total Cost**
		(Dollars in thousands)
December 21, 2011	KTEK-AM, Houston, Texas	$ 2,601
March 28, 2011	WorshipHouseMedia	6,000
March 14, 2011	WBZS-AM, Pawtucket, Rhode Island	550
		$ 9,151

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 independent third-party appraisal of the estimated fair value of the acquired net assets as of the acquisition date for the 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 as described in Note 1- Summary of our Significant Accounting Policies. Intangible assets are also recorded at their estimated fair value and amortized using the straight-line method over their estimated useful lives as described in Note 1- Summary of our Significant Accounting Policies. The total acquisition consideration was allocated to the net assets acquired as follows:

	Net Broadcast Assets Acquired	**Net Internet Assets Acquired**	**Net Assets Acquired**
		(Dollars in thousands)	
Asset			
Property and equipment	$ 1,018	$ 8	$ 1,026
Broadcast licenses	2,130		2,130
Goodwill	3	2,143	2,146
Customer lists and contracts		80	80

Domain and brand names		457	457
Internally developed software		311	311
Customer relationships		2,451	2,451
Other amortizable intangible assets		550	550
	$ 3,151	$ 6,000	$ 9,151

On December 21, 2011, we completed the acquisition of KTEK-AM in Houston, Texas for $2.6 million, which includes $1.0 million of cash and $1.6 million netted against the unpaid portion of our note receivable. We began operating the station on March 5, 2010, pursuant to a long-term TBA. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the TBA date. The accompanying Consolidated Balance Sheets reflect the net assets of this entity as of the closing date. We previously sold the assets of KTEK-AM on March 28, 2008 for $7.8 million, which included $4.5 million in cash and $3.3 million in notes receivable of which we collected $1.8 million. Our 2011 purchase was partially funded by the unpaid portion of the note of $1.5 million.

On December 12, 2011, we redeemed \$12.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On November 17, 2011, Salem entered into 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 (together, the Subordinated

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Debt due to Related Parties). The proceeds of the Subordinated Debt due to Related Parties may be used to repurchase a portion of Salem s outstanding senior secured notes. Outstanding amounts under each subordinated 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 Credit Agreement referred to above plus 2% per annum. Interest is payable at the time of any repayment of principal. In addition, outstanding amounts under each subordinated line of credit must be repaid within three months from the time that such amounts are borrowed. The Subordinated Lines of Credit do not contain any covenants. At December 31, 2011, $9.0 million was outstanding under the Subordinated Debt due to Related Parties.

On November 15, 2011, we completed the Second Amendment to our Revolver entered on December 1, 2009, 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 credit 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 (as defined in the credit agreement) plus a spread of 1.25% per annum, which is adjusted based on our leverage ratio.

On September 6, 2011, we repurchased $5.0 million of the $9^5/_8$% Notes due 2016 for $5.1 million, or at a price equal to $102^7/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On June 1, 2011, we redeemed $17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On March 28, 2011, we completed the acquisition of the Internet business, WorshipHouseMedia, an on-line church media and video ministry website, for $6.0 million in cash. WorshipHouseMedia.com offers users worship and small group resources, including movie illustrations, song tracks, worship backgrounds, small group video curriculum and worship software, to churches that may face budget, time and in-house talent constraints. The site also includes WorshipHouseKids, which offers similar products designed to meet the needs of children s ministry media in the church. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date. The acquisition resulted in goodwill of $2.1 million representing the excess value of the business as a result of the integrated business model and services already established that provide future economic benefit to us.

On March 14, 2011, we completed the acquisition of radio station WDDZ-AM, Pawtucket, Rhode Island, for $0.6 million in cash. We began operating the station as WBZS-AM upon the close of the transaction. The accompanying Consolidated Balance Sheets and Consolidated Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date. On January 5, 2012, we entered into an APA to sell this radio station for $0.8 million.

On March 1, 2011, we sold radio station WAMD-AM in Aberdeen, Maryland resulting in a pre-tax loss of $0.2 million that was previously recognized upon entering into the agreement in September 2010.

On February 25, 2011, we sold radio station KXMX-AM in Los Angeles, California for $12.0 million, which was comprised of $11.0 million in cash and a $1.0 million promissory note. The $1.0 million promissory note has a three-year term, bearing interest at 7% compounded annually, due on February 25, 2016. The sale resulted in a pre-tax gain of $2.1 million.

On January 6, 2011, we sold radio station KKMO-AM in Seattle, Washington for $2.7 million in cash resulting in a pre-tax gain of $2.4 million.

On January 3, 2011, we began programming radio station KVCE-AM, Highland Park, Texas pursuant to a long-term TBA.

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A summary of our business acquisitions and asset purchases for the year ended December 31, 2010, none of which were individually or in aggregate material to our consolidated financial position as of the respective date of acquisition, is as follows:

Acquisition Date	Description	Total Cost
		(Dollars in thousands)
February 12, 2010	HotAir.com (business acquisition)	$ 2,000
June 8, 2010	GodTube.com (business acquisition)	2,500
August 3, 2010	WWRC-AM, Washington, D.C. (business acquisition)	3,090
September 1, 2010	Samaritan Fundraising (business acquisition)	800
Various	Purchase of various Internet domain names (asset purchases)	170
		$ 8,560

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 independent third-party appraisal of the estimated fair value of the acquired net assets as of the acquisition date for the 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 as described in Note 1- Summary of our Significant Accounting Policies. Intangible assets are also recorded at their estimated fair value and amortized using the straight-line method over their estimated useful lives as described in Note 1- Summary of our Significant Accounting Policies. The total acquisition consideration was allocated to the net assets acquired as follows:

	Net Broadcast Assets Acquired	Net Internet Assets Acquired	Net Assets Acquired
		(Dollars in thousands)	
Asset			
Property and equipment	$ 71	88	$ 159
Broadcast licenses	2,948		2,948
Goodwill	4	720	724
Customer lists and contracts		1,834	1,834
Domain and brand names		2,097	2,097
Affiliate agreements		450	450
Other amortizable intangible assets	67	281	348
Liabilities			
Contingent consideration arrangement		(200)	(200)
	$ 3,090	5,270	$ 8,360

On December 1, 2010, we redeemed \$12.5 million of the $9^5/_8$% 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 \$0.1 million of unamortized discount and \$0.3 million of bond issue costs associated with the $9^5/_8$% Notes.

On November 1, 2010, we amended our Revolver to allow 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 $9^5/_8$% Notes. The calculation of the Available Amount also pertains to the payment of dividends when the leverage ratio is above 5.0 to 1. Additionally, we increased the total capacity of the Revolver from \$30.0 million to \$40.0 million.

On September 28, 2010, we received approximately \$1.0 million as compensation for loss of our property rights under an Eminent Domain Petition from the Dallas Independent School District. We reduced the proceeds by the net book value of our property, which was not directly associated with the operations of radio station, KSKY-AM, Dallas, Texas, resulting in a pre-tax gain of \$0.3 million. The property rights related to our back-up transmitter site. We do not expect the loss of these property rights to negatively affect our operations.

On September 1, 2010, we acquired Samaritan Fundraising, a web-based fundraising products company, for $0.6 million in cash plus $0.2 million contingent consideration payable in the future based on achieving certain revenue and profit goals as specified in the APA. The accompanying Consolidated Balance Sheets and Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date. The acquisition resulted in goodwill of $0.3 million representing the excess value of the business as a result of the integrated business model and services already established that provide future economic benefit to us. As discussed above, we ceased operating this entity on December 31, 2011. The Consolidated Balance Sheets and Statements of Operations for all periods presented are reclassified to reflect the operating results and net assets of this entity as a discontinued operation.

On August 3, 2010, we completed the acquisition of WWRC-AM in Washington, D.C. for $3.1 million. We had begun operating the station under a LMA effective May 15, 2010. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the LMA date. The accompanying Consolidated Balance Sheets reflect the net assets of this entity as of the closing date.

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On June 1, 2010, we redeemed $17.5 million of the $9^5/_8$% 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 $0.4 million of bond issue costs associated with the $9^5/_8$% Notes.

On June 8, 2010, we completed the acquisition of tangle.com and GodTube.com, Christian content and community websites, for $2.5 million. We ceased using the tangle.com name shortly after completing the acquisition having identified all acquired content under the GodTube.com brand. The accompanying Consolidated Balance Sheets and Statements of Operations reflect the operating results and net assets of these entities as of the acquisition date. The acquisition resulted in goodwill of $0.3 million representing the excess value of the business as a result of the integrated business model and services already established that provide future economic benefit to us.

On February 12, 2010, we completed the acquisition of HotAir.com, a website blog featuring news, analysis and commentary, for $2.0 million. The accompanying Consolidated Balance Sheets and Statements of Operations reflect the operating results and net assets of this entity as of the acquisition date. The acquisition resulted in goodwill of $0.2 million representing the excess value of the business as a result of the integrated business model and services already established that provide future economic benefit to us.

NOTE 4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following:

	As of December 31, 2011	As of December 31, 2012
	(Dollars in thousands)	
Land	$ 37,107	**$ 28,846**
Buildings	24,690	**24,663**
Office furnishings and equipment	37,523	**37,935**
Antennae, towers and transmitting equipment	73,517	**74,897**
Studio and production equipment	29,110	**29,234**
Computer software and website development costs	14,817	**18,859**
Record and tape libraries	65	**65**
Automobiles	1,031	**1,107**
Leasehold improvements	16,558	**16,721**
Construction-in-progress	2,512	**2,963**
	$ 236,930	**$ 235,290**
Less accumulated depreciation	(125,708)	**(135,823)**
	$ 111,222	**$ 99,467**

Depreciation expense was approximately $12.6 million, $12.5 million and $12.3 million for the years ended December 31, 2010, 2011, and 2012, respectively, which includes depreciation of $53,000 for each of the years ended December 31, 2010, 2011 and 2012 on a radio station tower that was valued at $0.8 million under a capital lease obligation. Accumulated depreciation associated with the capital lease was $185,000, $238,000 and $291,000 at December 31, 2010, 2011 and 2012, respectively.

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 based on the estimated sale price. In December 2012, after several purchase offers for the land were terminated, we obtained a third party valuation for the land. Based on this fair value appraisal, we recorded an additional $1.2 million impairment charge associated with the land.

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

		Fair Value Measurements Using: (Dollars in thousands)			
Description	As of December 31, 2012	Quoted prices in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Long-Lived Asset Held for Sale	$ 1,700			$ 1,700	$ 6,808

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NOTE 5. AMORTIZABLE INTANGIBLE ASSETS

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

	As of December 31, 2012		
	Cost	Accumulated Amortization	Net
		(Dollars in thousands)	
Customer lists and contracts	$ 17,213	$ (12,665)	$ 4,548
Domain and brand names	11,015	(7,192)	3,823
Favorable and assigned leases	1,649	(1,594)	55
Other amortizable intangible assets	3,997	(3,670)	327
	$ 33,874	$ (25,121)	$ 8,753

	As of December 31, 2011		
	Cost	Accumulated Amortization	Net
		(Dollars in thousands)	
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 December 31, 2012, we estimate amortization expense for the next five years to be as follows:

Year Ending December 31,	Amortization Expense
	(Dollars in thousands)
2013	$ 2,640
2014	2,319
2015	1,649
2016	879
2017	533
Thereafter	733
Total	$ 8,753

NOTE 6. NOTES PAYABLE AND LONG-TERM DEBT

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 Credit Facility

On December 1, 2009, our parent company, Salem Communications Corporation entered into 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 5/8% 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 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. We believe the borrowing capacity of the Revolver allows us to meet our ongoing operating requirements, fund capital expenditures, and satisfy our debt service requirements. 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. Amounts outstanding under the Revolver may be paid and then reborrowed at Salem s discretion without penalty or premium. At December 31, 2012, the blended interest rate on amounts outstanding under the Revolver was 3.32%.

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 maximum leverage ratio declines over time until December 31, 2014, at which point it is 5.50 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 December 31, 2012, our leverage ratio was 4.87 to 1 and our interest coverage ratio was 2.23 to 1. We were in compliance with our debt covenants under the Revolver at December 31, 2012, and we remain in compliance.

Senior Secured Second Lien Notes

On December 1, 2009, we issued $300.0 million principal amount of $9^5/_8$% 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 $9^5/_8$% Notes that are due in full in December 2016. The $9^5/_8$% 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 $9^5/_8$% Notes. As of December 31, 2011 and 2012, accrued interest on the $9^5/_8$% Notes was $1.0 million and $0.9 million, respectively. The discount is being amortized to interest expense over the term of the $9^5/_8$% Notes based on the effective interest method. For each of the twelve months ended December 31, 2012 and 2011, approximately $0.2 million, respectively, of the discount has been recognized as interest expense.

On December 12, 2012, we redeemed $4.0 million of the $9^5/_8$% Notes for $4.1 million, or at a price equal to 103% of the face value. This transaction resulted in a $0.2 million pre-tax loss on the early retirement of debt, including approximately $17,000 of unamortized discount and $0.1 million of bond issue costs associated with the $9^5/_8$% Notes.

On June 1, 2012, we redeemed $17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On December 12, 2011, we redeemed $12.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

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On September 6, 2011, we repurchased $5.0 million of the $9^5/_8$% Notes for $5.1 million, or at a price equal to $102^7/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

On June 1, 2011, we redeemed $17.5 million of the $9^5/_8$% 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 issue costs associated with the $9^5/_8$% Notes.

Information regarding repurchases and redemptions of the $9^5/_8$% Notes are as follows:

Date	Principal Redeemed/Repurchased	Premium Paid	Unamortized Discount	Bond Issue Costs
		(Dollars in thousands)		
December 12, 2012	$ 4,000	$ 120	$ 17	$ 57
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 $9^5/_8$% Notes was $233.8 million and $212.6 million at December 31, 2011 and 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 December 31, 2012, the outstanding principal balance on the FCB loan was $7.5 million with approximately $23,906 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 December 31, 2012, our leverage ratio was 4.87 to 1 and our interest coverage ratio was 2.23 to 1. We were in compliance with our debt covenants under the FCB Loan at December 31, 2012, and we remain in compliance.

Subordinated Debt due to Related Parties

On November 17, 2011, we entered into subordinated 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 subordinated 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 subordinated 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 Subordinated Debt due to Related Parties).

The proceeds of the subordinated lines of credit may be used to repurchase a portion of Salem s outstanding $9^5/_8$% Notes. Outstanding amounts under each subordinated 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 subordinated line of credit must be repaid within three (3) months from the time that such amounts are borrowed, with the exception of the subordinated line of credit with Mr. Hinz, which must be repaid within six (6) months from the time that such amounts are borrowed. The subordinated lines of credit do not contain any covenants. At December 31, 2011 and 2012, $9.0 million and $15.0 million, respectively, was outstanding under the Subordinated Debt due to Related Parties.

Because the transactions with Msrs. 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 subordinated lines of credit any definitive credit agreements associated therewith. As part of its consideration, the Committee concluded that the terms of the subordinated lines of credit were more favorable to Salem as compared to terms of lines of credit available from unaffiliated third parties. Additionally, in August 2012, the company obtained a fairness opinion from Bond & Pecaro confirming this conclusion.

Summary of long-term debt obligations

Long-term debt consisted of the following:

	As of December 31,	
	2011	**2012**
	(Dollars in thousands)	
Revolver under senior credit facility	$ 31,000	**$ 33,000**
$9^5/_8$% senior secured second lien notes due 2016	233,846	**212,622**
Subordinated debt		**7,500**
Subordinated debt due to related parties	9,000	**15,000**
Capital leases and other loans	957	**858**
	274,803	**268,980**
Less current portion	(9,124)	**(20,108)**
	$ 265,679	**$ 248,872**

In addition to the amounts listed above, we also have interest payments related to our long-term debt as follows as of December 31, 2012:

Outstanding borrowings of $33.0 million under the Revolver, with interest payments due at LIBOR plus 3.00% or at prime rate plus 1.25%;

$213.5 million $9^5/_8$% Notes with semi-annual interest payments at an annual rate of $9^5/_8$%;

Outstanding borrowings of $7.5 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 data processing equipment. The obligation recorded at December 31, 2011 and 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 December 31, 2012 for each of the next five years and thereafter are as follows:

	Amount *(Dollars in thousands)*
2013	$ **20,108**
2014	**2,599**
2015	**33,083**
2016	**212,692**
2017	**76**
Thereafter	**422**
	$ **268,980**

NOTE 7. 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 December 31, 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 8. INCOME TAXES

The consolidated provision (benefit) for income taxes from continuing operations for Salem consisted of the following:

	December 31, 2010	December 31, 2011	December 31, 2012
	(Dollars in thousands)		
Current:			
Federal	$ (4)	$ (8)	**$ 8**
State	286	282	**198**
	282	274	**206**
Deferred:			
Federal	1,887	4,425	**3,649**
State	526	1,411	**(3,702)**
	2,413	5,836	**(53)**
Provision for (benefit from) income taxes	$ 2,695	$ 6,110	**$ 153**

Discontinued operations are reported net of the tax benefit of $0.03 million in 2010, $0.5 million in 2011 and $(0.06) million in 2012.

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The consolidated deferred tax asset and liability consisted of the following:

	December 31, 2011	December 31, 2012
	(Dollars in thousands)	
Deferred tax assets:		
Financial statement accruals not currently deductible	$ 6,303	**$ 6,146**
Net operating loss, AMT credit and other carryforwards	54,327	**58,702**
State taxes	100	**103**
Other	2,864	**3,014**
Total deferred tax assets	63,594	**67,965**
Valuation allowance for deferred tax assets	(2,798)	**(2,913)**
Net deferred tax assets	$ 60,796	**$ 65,052**
Deferred tax liabilities:		
Excess of net book value of property, plant, equipment and software for financial reporting purposes over tax basis	$ 8,794	**$ 5,032**
Excess of net book value of intangible assets for financial reporting purposes over tax basis	89,824	**100,040**
Unrecognized tax benefits	3,852	**1,325**
Total deferred tax liabilities	102,470	**106,397**
Net deferred tax liabilities	$ (41,674)	**$ (41,345)**

The following table reconciles the above net deferred tax liabilities to the financial statements:

	December 31, 2011	December 31, 2012
	(Dollars in thousands)	
Deferred income tax asset per balance sheet	$ 6,403	**$ 6,248**
Deferred income tax liability per balance sheet	(48,077)	**(47,593)**
	$ (41,674)	**$ (41,345)**

A reconciliation of the statutory federal income tax rate to the provision for income tax is as follows:

	Year Ended December 31, 2010	2011	2012
		(Dollars in thousands)	
Statutory federal income tax rate (at 35%)	$ 1,638	$ 4,364	**$ 1,637**
Effect of state taxes, net of federal	525	1,102	**(2,278)**
Permanent items	174	696	**788**
ISO benefit	338		
Other, net	20	(52)	**6**
Provision for income taxes	$ 2,695	$ 6,110	**$ 153**

At December 31, 2012, we had net operating loss carryforwards for federal income tax purposes of approximately $125.9 million that expire in 2020 through 2032 and for state income tax purposes of approximately $844.5 million that expire in years 2013 through 2032. For financial reporting purposes at December 31, 2012, we had a valuation allowance of $2.9 million, net of federal benefit, to offset a portion of the deferred tax assets related to state net operating loss carryforwards that may not be realized.

NOTE 9. 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, 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 annual consolidated financial position, results of operations or cash flows.

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Salem leases various land, offices, studios and other equipment under operating leases that generally expire over the next ten to twenty-five years. The majority of these leases are subject to escalation clauses and may be renewed for successive periods ranging from one to five years on terms similar to current agreements and except for specified increases in lease payments. Rental expense included in operating expense under all lease agreements was $15.4 million, $14.9 million and $15.7 million in 2010, 2011 and 2012, respectively.

Future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2012, are as follows:

	Related Parties	Other	Total
		(Dollars in thousands)	
2013	**$ 1,319**	**$ 9,267**	**$ 10,586**
2014	**1,245**	**8,948**	**10,193**
2015	**1,250**	**8,152**	**9,402**
2016	**1,202**	**5,855**	**7,057**
2017	**1,009**	**3,817**	**4,826**
Thereafter	**4,330**	**26,046**	**30,376**
	$ 10,355	**$ 62,085**	**$ 72,440**

NOTE 10. STOCK OPTION PLAN

We have one stock option plan. The Amended and Restated 1999 Stock Incentive Plan (the Plan) allows the company to grant equity-based awards, including stock options and restricted share awards to employees, advisors and non-employee members of the Board of Directors to 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, have 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.

During the year ending December 31, 2012, the Board of Directors accelerated the vesting period for two outstanding stock awards issued to two employees. This accelerated vesting resulted in additional compensation cost of $0.1 million recognized in the fourth quarter of 2012. The following table reflects the components of stock-based compensation expense recognized in the Consolidated Statements of Operations for the years ended December 31, 2010, 2011 and 2012:

	Year Ended December 31,		
	2010	2011	**2012**
		(Dollars in thousands)	
Stock option compensation expense included in corporate expenses	$ 947	**$ 603**	**$ 933**
Restricted stock shares compensation expense included in corporate expenses	17	**4**	
Stock option compensation expense included in broadcast operating expenses	380	**281**	**305**
Stock option compensation expense included in Internet operating expenses	79	**52**	**111**
Stock option compensation expense included in publishing operating expenses	14	**10**	**19**
Total stock-based compensation expense, pre-tax	$ 1,437	**$ 950**	**$ 1,368**
Tax benefit (expense) from stock-based compensation expense	(792)	**(220)**	**(579)**
Total stock-based compensation expense, net of tax	$ 645	**$ 730**	**$ 789**

Stock option 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 7, 2012, May 31, 2012, August 30, 2012, and November 29, 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 years ended December 31, 2010, 2011 and 2012:

	Year Ended December 31,		
	2010	2011	**2012**
Expected volatility	94.26%	101.49%	**102.37%**
Expected dividends	0.0%	0.0%	**5.07%**
Expected term (in years)	7.3	7.5	**8.2**
Risk-free interest rate	3.11%	1.64%	**1.66%**

Stock option information with respect to the company s stock-based compensation plans during the three years ended December 31, 2012 is as follows (Dollars in thousands, except weighted average exercise price and weighted average grant date fair value):

Options	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2010	1,341,875	$ 5.01	$ 3.80	5.0 years	$ 4,762
Granted	430,500	5.20	4.32		
Exercised	(557,451)	0.61	0.41		1,718
Forfeited or expired	(62,926)	11.88	8.79		
Outstanding at December 31, 2010	1,151,998	$ 6.83	$ 5.36	5.0 years	$ 748
Exercisable at December 31, 2010	560,151	$ 8.79	$ 5.73	3.3 years	$ 554
Expected to Vest	561,959	$ 4.97	$ 5.01	6.5 years	$ 184
Outstanding at January 1, 2011	1,151,998	$ 6.83	$ 5.36	5.0 years	$ 748
Granted	630,000	2.43	2.05		116
Exercised	(41,112)	0.59	0.42		125
Forfeited or expired	(100,494)	11.47	7.72		22
Outstanding at December 31, 2011	1,640,392	$ 5.01	$ 4.07	5.2 years	$ 584
Exercisable at December 31, 2011	655,228	7.56	5.47	2.9 years	414
Expected to Vest	980,189	$ 3.31	$ 3.13	6.8 years	$ 170
Outstanding at January 1, 2012	**1,640,392**	**$ 5.01**	**$ 4.07**	**5.2 years**	**$ 584**
Granted	**626,000**	**2.74**	**1.51**		**1,704**
Exercised	**(261,205)**	**1.57**	**1.28**		**910**

Forfeited or expired	**(78,088)**		**14.06**		**8.03**			**10,824**
Outstanding at December 31, 2012	**1,927,099**	**$**	**4.37**	**$**	**3.45**	**5.4 years**	**$**	**3,899**
Exercisable at December 31, 2012	**707,024**		**6.58**		**5.41**	**2.9 years**		**1,004**
Expected to Vest	**1,158,461**	**$**	**3.09**	**$**	**2.32**	**6.8 years**	**$**	**2,749**

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The aggregate intrinsic value represents the difference between the company s closing stock price on December 31, 2012 of $5.46 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 years ended December 31, 2010, 2011 and 2012 was $1.1 million, $1.0 million and $1.2 million, respectively.

The fair values of shares of restricted stock are determined based on the closing price of the company common stock on the grant dates. There were no restricted stock awards outstanding during the year ending December 31, 2012. Information regarding the company s restricted stock during the years ended December 31, 2010 and 2011 is as follows:

Restricted Stock	Shares	Weighted Average Grant Date Fair Value
Non-Vested at January 1, 2010	5,000	$ 0.36
Granted	10,000	2.03
Lapsed	(5,000)	0.36
Forfeited		
Non-Vested at December 31, 2010	10,000	$ 2.03
Non-Vested at January 1, 2011	10,000	$ 2.03
Granted		
Lapsed	(10,000)	2.03
Forfeited		
Non-Vested at December 31, 2011		$

As of December 31, 2012, there was $1.2 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 2.1 years.

Additional information regarding options outstanding as of December 31, 2012, is as follows:

Range of Exercise Prices	Options	Weighted Average Contractual Life Remaining (Years)	Weighted Average Exercise Price	Exercisable Options	Weighted Average Exercise Price
$ 0.36 - $ 3.00	1,206,024	6.5	$ 2.40	223,399	$ 1.48
$ 3.01 - $ 6.00	500,750	4.6	5.07	263,300	5.05
$ 6.01 - $ 9.00	1,500	2.4	7.99	1,500	7.99
$ 9.01 - $ 12.00	93,400	1.7	11.80	93,400	11.80
$ 12.01 - $ 15.00	87,775	1.4	13.89	87,775	13.89
$ 15.01 - $ 18.00	27,750	0.9	16.75	27,750	16.75
$ 18.01 - $ 21.00	9,250	1.4	18.89	9,250	18.89
$ 21.01 - $ 24.00					
$ 24.01 - $ 25.50	650	0.7	24.78	650	24.78
$ 0.36 - $ 25.50	**1,927,099**	**5.4**	**$ 4.37**	**707,024**	**$ 6.58**

NOTE 11. RELATED PARTY TRANSACTIONS

Our board of directors has adopted a written policy for review, approval and monitoring of transactions between the company and its related parties. Related parties include our directors, executive officers, nominees to become a director, any person beneficially owning more than 5% of any class of our stock, immediate family members of any of the foregoing, and any entity in which any of the foregoing persons is employed or is a general partner or principal or in which the person has a 10% or greater beneficial ownership interest. The policy covers material transactions in which a related party had, has or will have a direct or indirect interest.

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Leases with Principal Stockholders

A trust controlled by the Chief Executive Officer of the company, Edward G. Atsinger III, owns real estate on which assets of one radio station are located. Salem has entered into a lease agreement with this trust. Rental expense related to this lease included in operating expense for 2010, 2011 and 2012 amounted to $156,000, $160,000 and $165,000, respectively.

Land and buildings occupied by various Salem radio stations are leased from entities owned by the company s CEO and its Chairman of the Board. Rental expense under these leases included in operating expense for 2010, 2011 and 2012 amounted to $1.3 million, respectively.

Subordinated Debt due to Related Parties

On November 17, 2011, we entered into subordinated 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 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 Subordinated Debt due to Related Parties).

The proceeds of the Subordinated Debt due to Related Parties may be used to repurchase a portion of Salem s outstanding 9 5/8% Notes. Outstanding amounts under each subordinated 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 subordinated line of credit must be repaid within three (3) months from the time that such amounts are borrowed, with the exception of the subordinated line of credit with Mr. Hinz, which must be repaid within six (6) months from the time that such amounts are borrowed. The subordinated lines of credit do not contain any covenants. At December 31, 2011 and 2012, $9.0 million and $15.0 million, respectively, was outstanding under the Subordinated Debt due to Related Parties.

Because the transactions with Msrs. 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 subordinated lines of credit and any definitive credit agreements associated therewith. As part of its consideration, the Committee concluded that the terms of the subordinated lines of credit were more favorable to Salem as compared to terms of lines of credit available from unaffiliated third parties. Additionally, in August 2012, the company obtained a fairness opinion from Bond & Pecaro confirming this conclusion.

Radio Stations Owned by the Epperson s

Nancy A. Epperson, the wife of the Chairman of the Board, Stuart W. Epperson, currently serves as an officer, director and stockholder of six radio stations in Virginia, five radio stations in North Carolina, and five radio stations in Florida. Chesapeake-Portsmouth Broadcasting Corporation (Chesapeake-Portsmouth) is a company controlled by Nancy Epperson, wife of Salem s Chairman of the Board Stuart W. Epperson and sister of CEO Edward G. Atsinger III. Chesapeake-Portsmouth owns and operates radio stations WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida.

The markets where these radio stations are located are not currently served by stations owned and operated by the company. Under his employment agreement, Mr. Epperson is required to offer the company a right of first refusal of opportunities related to the company s business.

Radio Stations Owned by Mr. Hinz

Mr. Hinz, a director of the company, through companies or entities controlled by him, operates three radio stations in Southern California. These radio stations are formatted in Christian Teaching and Talk programming in the Spanish language.

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Truth For Life Mr. Hinz, Mr. Riddle and Mrs. Weinberg

Truth For Life is a non-profit organization that is a customer of Salem Communications. During 2010, 2011 and 2012, the company billed Truth For Life approximately $2.0 million, $1.9 million and $2.1 million, respectively, for airtime on its stations. Mr. Hinz, a director of the company was an active member of the board of directors of Truth for Life during 2009 and through September 2010. Mr. Riddle, a director of the company, joined the Truth for Life board in October 2010 and remains a member of this board. Mrs. Allyson Weinberg is the wife of the company s director Dennis M. Weinberg. Mrs. Weinberg joined the board of Truth for Life in April 2011 and remains a member of this board.

Know the Truth Mr. Riddle

Know the Truth is a non-profit organization that is a customer of Salem Communications. During 2010, 2011 and 2012, the company billed Know the Truth approximately $0.3 million, $0.3 million and $0.4 million, respectively, for airtime on its stations. Mr. Riddle, a director of the company, joined the Know the Truth board 2010 and remains a member of this board.

Split-Dollar Life Insurance

The company purchased split-dollar life insurance policies for its Chairman and Chief Executive Officer in 1997. During 2011, the then existing policies were cancelled and new policies were entered. The company is the owner of the policies and is entitled to recover all of the premiums paid on these policies. The company records an asset based on the lower of the aggregate premiums paid or insurance cash surrender value. The premiums were $230,000, $990,000 and $193,000, for each of the years ended December 31, 2010, 2011 and 2012, respectively. As of December 31, 2010, 2011, and 2012 we recorded net assets of $2.8 million, $1.1 million and $1.3 million, respectively. Benefits above and beyond the cumulative premiums paid will go to the beneficiary trusts established by each of the Chairman and Chief Executive Officer.

Transportation Services Supplied by Atsinger Aviation

From time to time, the company rents aircraft from a company that is owned by Edward G. Atsinger III, Chief Executive Officer and director of Salem. As approved by the independent members of the company s board of directors, the company rents these aircraft on an hourly basis at what the company believes are market rates and uses them for general corporate needs. Total rental expense for these aircraft for 2010, 2011 and 2012 amounted to approximately $209,000, $402,000 and $386,000, respectively.

Other Related Party Transactions

On June 3, 2010, we entered into a related party transaction under which the company purchased the former primary residence of our President, Radio Division. The transaction was entered to facilitate the relocation of the President, Radio Division, in order for him to reside near the corporate office as necessary to effectively perform employment-related duties. We obtained an independent third-party appraisal of the purchase price of the residence for $0.7 million. On December 29, 2010, the property sold for $0.5 million, resulting in a pre-tax loss of $0.2 million.

During the period ended March 31, 2010, we recorded a loss of $0.2 million associated with a second lien real estate note with an employee.

NOTE 12. DEFINED CONTRIBUTION PLAN

We maintain a 401(k) defined contribution plan (the 401(k) Plan), which covers all eligible employees (as defined in the 401(k) Plan). Participants are allowed to make non-forfeitable contributions up to 60% of their annual salary, but may not exceed the annual maximum contribution limitations established by the Internal Revenue Service. The plan previously allowed for a company match of 50% on the first 3% of the amounts contributed by each participant and 25% on the next 3% contributed but does not match participants contributions in excess of 6% of their compensation per pay period. The company match was temporarily suspended in July 2008 as part of an extensive cost-reduction program. The company match was reinstated effective January 1, 2012 under new terms that allow for a company match of 50% on the first 5% of the amounts contributed by each participant. During the year ending December 31, 2012, we contributed and expensed $1.3 million in the 401(k) Plan.

NOTE 13. STOCKHOLDERS EQUITY

Holders of Class A common stock are entitled to one vote per share and holders of Class B common stock are entitled to ten votes per share, except for specified related party transactions. Holders of Class A common stock and Class B common stock vote together as a single class on all matters submitted to a vote of stockholders, except that holders of Class A common stock vote separately for two independent directors.

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 $0.035 per share, were paid on March 30, 2012, June 29, 2012, September 28, 2012 and December 28, 2012, to all common stockholders of record. We paid $3.4 million in dividends during 2012. 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 December 13, 2010, we paid a special cash distribution of $0.20 per share on its Class A and Class B common stock to shareholders of record as of the close of business on December 6, 2010. The distribution amounted to approximately $4.8 million.

We account for stock-based compensation expense in accordance with FASB ASC Topic 718 Compensation Stock Expense. As a result, $1.4 million, $1.0 million and $1.4 million of non-cash stock-based compensation expense has been recorded to additional paid-in capital for the year ended December 31, 2010, 2011, and 2012, respectively.

NOTE 14. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED):

The following table sets forth selected financial results of the company on a quarterly basis.

	March 31		**June 30**		**September 30**		**December 31**	
	2011	2012	2011	2012	2011	2012	2011	2012
	(Dollars in thousands, except per share data)							
Total revenue	$ 51,163	**$ 54,284**	$ 55,440	**$ 57,626**	$ 54,503	**$ 56,719**	$ 57,060	**$ 60,550**
Operating income (loss)	11,918	**7,930**	9,920	**3,862**	9,286	**8,479**	10,875	**10,219**
Net income (loss) before discontinued operations	2,559	**885**	1,085	**(1,779)**	1,689	**3,407**	1,026	**2,010**
Net income (loss)	$ 2,587	**$ 843**	$ 1,100	**$ (1,792)**	$ 1,485	**$ 3,368**	$ 446	**$ 2,009**
Basic earnings (loss) per share	$ 0.10	**$ 0.04**	$ 0.04	**$ (0.07)**	$ 0.07	**$ 0.14**	$ 0.04	**$ 0.08**
Basic earnings (loss) per share from continuing operations	$ 0.11	**$ 0.03**	$ 0.05	**$ (0.07)**	$ 0.06	**$ 0.13**	$ 0.02	**$ 0.08**
Diluted earnings (loss) per share	$ 0.10	**$ 0.04**	$ 0.04	**$ (0.07)**	$ 0.07	**$ 0.14**	$ 0.04	**$ 0.08**
Diluted earnings (loss) per share from continuing operations	$ 0.10	**$ 0.03**	$ 0.04	**$ (0.07)**	$ 0.06	**$ 0.13**	$ 0.02	**$ 0.08**
Weighted average shares outstanding basic	24,520,858	**24,564,947**	24,279,251	**24,356,298**	24,546,056	**24,663,027**	24,554,245	**24,726,148**
Weighted average shares outstanding diluted	24,759,253	**24,753,671**	24,491,530	**24,356,298**	24,746,164	**25,358,052**	24,737,629	**25,266,368**

NOTE 15. SEGMENT DATA

FASB ASC Topic 280 Segment Reporting requires companies to provide certain information about their operating segments. We have historically had one reportable operating segment radio broadcasting. Our radio broadcasting segment operates radio stations throughout the United States, as well as various radio networks and our National sales group. Beginning with the first quarter of 2011, we separated our non-broadcast segment into two operating segments, Internet and Publishing. We believe that this information regarding our non-broadcast segment is useful to readers of our financial statements. Additionally, due to growth within our Internet operations, including the acquisition of WorshipHouseMedia.com on March 28, 2011, our Internet segment meets the threshold for disclosure as a reportable segment. All prior periods presented have been updated to separate these non-broadcast segments. 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.

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Management uses operating income before depreciation, amortization, impairments of indefinite-lived intangible assets, (gain) loss on disposal of assets, and costs of denied towers, abandoned projects and terminated transactions as its measure of profitability for purposes of assessing performance and allocating resources.

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	Radio Broadcast	Internet	Publishing	Corporate	Consolidated
			(Dollars in thousands)		
Year Ended December 31, 2012					
Net revenue	**$ 183,180**	**$ 33,474**	**$ 12,525**	**$**	**$ 229,179**
Operating expenses	**120,772**	**25,145**	**12,288**	**18,892**	**177,097**
Operating income (loss) before depreciation, amortization, impairment of long-lived assets and (gain) loss on disposal of assets	**$ 62,408**	**$ 8,329**	**$ 237**	**$ (18,892)**	**$ 52,082**
Depreciation	**8,274**	**2,438**	**423**	**1,208**	**12,343**
Amortization	**105**	**2,189**	**8**	**2**	**2,304**
Impairment of long-lived assets	**6,808**		**88**		**6,896**
(Gain) loss on disposal of assets	**84**	**(76)**		**41**	**49**
Operating income (loss)	**$ 47,137**	**$ 3,778**	**$ (282)**	**$ (20,143)**	**$ 30,490**
Year Ended December 31, 2011					
Net revenue	$ 178,731	$ 27,304	$ 12,131	$	$ 218,166
Operating expenses	115,482	20,889	11,475	17,503	165,349
Operating income (loss) before depreciation, amortization and (gain) loss on disposal of assets	$ 63,249	$ 6,415	$ 656	$ (17,503)	$ 52,817
Depreciation	8,834	2,139	308	1,239	12,520
Amortization	136	2,186	127	2	2,451
(Gain) loss on disposal of assets	(4,332)	(11)	23	167	(4,153)
Operating income (loss)	$ 58,611	$ 2,101	$ 198	$ (18,911)	$ 41,999
Year Ended December 31, 2010					
Net revenue	$ 174,933	$ 20,104	$ 11,421	$	$ 206,458
Operating expenses	110,421	16,722	11,226	16,613	154,982
Operating income (loss) before depreciation, amortization and (gain) loss on disposal of assets	$ 64,512	$ 3,382	$ 195	$ (16,613)	$ 51,476
Depreciation	9,391	1,771	263	1,145	12,570
Amortization	102	1,637	274	5	2,018
(Gain) loss on disposal of assets	(10)	7	55	203	255
Operating income (loss)	$ 55,029	$ (33)	$ (397)	$ (17,966)	$ 36,633

	Radio Broadcast	Internet	Publishing	Corporate	Consolidated
			(Dollars in thousands)		
As of December 31, 2012					
Property, plant and equipment, net	**$ 82,972**	**$ 6,309**	**$ 1,271**	**$ 8,915**	**$ 99,467**
Broadcast licenses	**373,720**				**373,720**
Goodwill	**3,881**	**17,157**	**1,337**	**8**	**22,383**
Other indefinite-lived intangible assets			**1,873**		**1,873**
Amortizable intangible assets, net	**106**	**8,634**	**11**	**2**	**8,753**
As of December 31, 2011					

Total 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 16. SUBSEQUENT EVENTS

On February 25, 2013, we launched a tender offer to purchase for cash any and all of the outstanding 9 $^{5}/_{8}$% Notes and a related consent solicitation (collectively, the Tender Offer) to amend the indenture governing the 9 $^{5}/_{8}$% Notes (the Indenture). In connection with the Tender Offer, we plan to enter into a new senior secured term loan of up to $300 million, which will be used to fund the purchase of any 9 $^{5}/_{8}$% Notes that are tendered in the Tender Offer. We also plan to enter into a new senior secured revolving

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credit facility of up to $25 million. If the requisite consents have been obtained from holders of the 9 $^{5}/_{8}$% Notes in the Tender Offer, substantially all of the restrictive covenants, certain events of default and other provisions contained in the Indenture will be eliminated and the liens on the assets that secure the 9 $^{5}/_{8}$% Notes will be released, making any 9 $^{5}/_{8}$% Notes that remain outstanding after the consummation of the Tender Offer effectively subordinated to the new term loan and the new revolving credit facility to the extent of the value of the collateral. The proceeds from these facilities will be used to fund the Tender Offer and retire all other outstanding corporate debt. Holders of the 9 $^{5}/_{8}$% Notes who tender by the consent payment deadline, which is 5:00 pm, New York City time, on March 8, 2013, will receive a consent payment as part of the Tender Offer consideration. The Tender Offer is anticipated to expire at 12:00 midnight, New York City time, on March 22, 2013. Regardless of whether we obtain the requisite consents from holders of the 9 $^{5}/_{8}$% Notes in the Tender Offer, we intend, at our sole discretion and without any obligation to do so, to retire any 9 $^{5}/_{8}$% Notes that are not tendered in the Tender Offer in accordance with the terms of the Indenture, which may include redeeming the 9 $^{5}/_{8}$% Notes at a redemption price equal to 100.0% of the principal amount of the 9 $^{5}/_{8}$% Notes redeemed plus the Applicable Premium (as defined in the Indenture) as of, and accrued and unpaid interest, if any, to, but not including, the redemption date (the Make Whole Redemption) and/or pursuant to a provision in the Indenture whereby, prior to December 15, 2013, we may redeem up to an aggregate $30.0 million of the 9 $^{5}/_{8}$% Notes in any 12-month period, in connection with up to two redemptions in such 12-month period, at a redemption price of 103.0% of the principal amount thereof, plus accrued and unpaid interest to the redemption date (the 10% Redemption). The first $26.0 million of untendered 9 $^{5}/_{8}$% Notes are expected to be redeemed pursuant to the 10% Redemption on June 1, 2013, the next $4.0 million of untendered 9 $^{5}/_{8}$% Notes are expected to be redeem pursuant to the 10% Redemption on December 12, 2013, and the balance of untendered 9 $^{5}/_{8}$% Notes are expected to be redeemed pursuant to the Make Whole Redemption on the applicable redemption date following the requisite notice. Upon entry into the new term loan and the new revolving credit facility, the Revolver, FCB Loan, and Subordinated Debt due to Related Parties will be terminated.

On December 3, 2012, we began operating radio station WMUU-FM, Greenville, South Carolina under an LMA with the owner. We have agreed to acquire the radio station for $6.0 million. The $6.0 million purchase price consists 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 acquisition of this radio station closed on February 5, 2013. Effective February 11, 2013, we changed the call letters of this station to WGTK-FM.

On November 1, 2012, we began operating radio station WJKR-FM, Columbus, Ohio under an LMA with the owner. The accompanying Consolidated Statements of Operations reflect the operating results of this entity as of the LMA date. The acquisition of this radio station closed on February 15, 2013. Effective February 15, 2013, we changed the call letters of this station to WTOH-FM.

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

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports pursuant to the Exchange Act, is recorded accurately, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. As required by Rules 13a-15(b) and 15d-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of senior management, including our Chief Executive Officer and our Chief Financial Officer, of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this report.

(b) Management s Annual Report on Internal Control Over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the

supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our internal control over financial reporting as of December 31, 2012 based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under that framework and applicable Securities and Exchange Commission rules, our management concluded that our internal control over financial reporting was effective as of December 31, 2012.

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(c) Attestation Report of Registered Public Accounting Firm. This annual report does not include an attestation report of our registered public accounting firm regarding the internal control over financial reporting. Management s report was not subject to attestation by our registered public accounting firm pursuant to rules of the SEC that permit us to provide only management s report in this annual report.

(d) Changes in Internal Control Over Financial Reporting. There were no changes in our internal control over financial reporting during our fourth fiscal quarter for 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION.
Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.
The information required by this item is incorporated by reference to our Definitive Proxy Statement under the heading DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT, expected to be filed within 120 days of our fiscal year end.

ITEM 11. EXECUTIVE COMPENSATION.
The information required by this item is incorporated by reference to our Definitive Proxy Statement under the heading EXECUTIVE COMPENSATION, expected to be filed within 120 days of our fiscal year end.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.
The information required by this item is incorporated by reference to our Definitive Proxy Statement under the heading SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS expected to be filed within 120 days of our fiscal year end.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.
The information required by this item relating to Certain Relationships and Related Party Transactions is incorporated by reference to our Definitive Proxy Statement under the heading CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS expected to be filed within 120 days of our fiscal year end.

The information required by this item relating to Director Independence is incorporated by reference to our Definitive Proxy Statement under the heading DIRECTOR INDEPENDENCE expected to be filed within 120 days of our fiscal year end.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.
The information required by this item is incorporated by reference to our Definitive Proxy Statement under the heading PRINCIPAL ACCOUNTING FEES AND SERVICES, expected to be filed within 120 days of our fiscal year end.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.
(a)

1. Financial Statements. The financial statements required to be filed hereunder are included in Item 8.

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2. Financial Statement Schedule. The following financial statement schedule for the years ended December 31, 2010, 2011 and 2012 is filed as part of this report and should be read in conjunction with the consolidated financial statements.

SALEM COMMUNICATIONS CORPORATION

Schedule II Valuation & Qualifying Accounts

(Dollars in thousands)

Description	Balance at Beginning of Period	Additions Charged to Cost and Expense	Deductions Bad Debt Write-offs	Balance at End of Period
Year Ended December 31, 2010 Allowance for Doubtful Accounts	10,303	2,198	(2,475)	10,026
Year Ended December 31, 2011 Allowance for Doubtful Accounts	10,026	2,069	(2,795)	9,300
Year Ended December 31, 2012 Allowance for Doubtful Accounts	9,300	2,554	(2,928)	8,926

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

3. Exhibits.

EXHIBIT LIST

Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
3.01	Amended and Restated Certificate of Incorporation of Salem Communications Corporation, a Delaware corporation.	8-K	333-41733-29	04/14/99	3.1	
3.02.02	Amended and Restated Bylaws of Salem Communications Corporation, a Delaware Corporation.	8-K	000-26497	06/26/07	3.1	
3.03	Certificate of Incorporation of Salem Communications Holding Corporation.	8-K	000-26497	09/08/00	2.01	
3.04.02	Amended and Restated Bylaws of Salem Communications Holding Corporation, a Delaware Corporation.	10-Q	000-26497	08/09/07	3.04.01	
3.05	Certificate of Incorporation of Salem Communications Acquisition Corporation.	8-K	000-26497	09/08/00	2.03	
3.06	Bylaws of Salem Communications Acquisition Corporation.	8-K	000-26497	09/08/00	2.04	
3.07	Certificate of Incorporation of SCA License Corporation.	8-K	000-26497	09/08/00	2.06	
3.08	Bylaws of SCA License Corporation.	8-K	000-26497	09/08/00	2.06	
4.01	Specimen of Class A common stock certificate.	S-1/A	333-76649	Declared Effective 6/30/99	4.09	
4.02	Second Amended and Restated Parent Security Agreement dated as of June 15, 2001, by and among Salem Communications Corporation, a Delaware corporation, Salem Communications Holding Corporation, a Delaware corporation, and The Bank of New York, as Administrative Agent.	10-Q	000-26497	08/14/01	4.24.02	
4.03	Indenture between Salem Communications Holding Corporation, a Delaware corporation, certain named guarantors and The Bank of New York, as Trustee, dated as of June 25, 2001, relating to the 9% Series A and Series B Senior Subordinated Notes due 2011.	10-Q	000-26497	08/14/01	4.10.03	
4.04	Form of 9% Senior Subordinated Notes (filed as part of exhibit 4.06).	10-Q	000-26497	08/14/01		
4.05	Form of Note Guarantee (filed as part of exhibit 4.06).	10-Q	000-26497	08/14/01		
4.06	Registration Rights Agreement dated as of June 25, 2001, by and among Salem Communications Holding Corporation, the guarantors and initial purchasers named therein.	10-Q	000-26497	08/14/01	4.28	
4.07	Indenture, dated as of December 23, 2002, relating to the 7 $^{3}/_{4}$% Senior Subordinated Notes due 2010 by and among Salem Holding, the Company and The Bank of New York, as trustee, with form of Note incorporated.	8-K	000-26497	12/23/02	4.10	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
4.08	Form of 7 $^3/_4$% Senior Subordinated Notes (filed as part of exhibit 4.10).	8-K	000-26497	12/23/02		
4.09	Form of Note Guarantee (filed as part of exhibit 4.10).	8-K	000-26497	12/23/02		
4.10	Supplemental Indenture No. 1 to the 7 $^3/_4$% Senior Subordinated Notes, dated as of December 23, 2002, between Salem Communications Corporation and its guarantors, and Bank of New York.	10-K	000-26497	03/31/03	4.22	
4.11	Supplemental Indenture No. 1 to the 9% Senior Subordinated Notes, dated as of December 16, 2002, between Salem Communications Corporation and its guarantors, and Bank of New York.	10-K	000-26497	03/31/03	4.23	
4.12	Supplemental Indenture No. 2 to the 7 $^3/_4$% Senior Subordinated Notes, dated as of June 12, 2003, between Salem Communications Corporation and its guarantors, and Bank of New York.	10-Q	000-26497	08/06/03	4.24	
4.13	Supplemental Indenture No. 2 to the 9% Senior Subordinated Notes, dated as of June 12, 2003, between Salem Communications Corporation and its guarantors, and Bank of New York.	10-Q	000-26497	08/06/03	4.25	
4.14	Indenture, dated as of December 1, 2009, among Salem Communications Corporation, the subsidiary guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Trustee and Collateral Agent.	8-K	000-26497	12/03/09	4.1	
4.15	Form of 9.625% Senior Secured Second Lien Notes due 2016 (filed as part of Exhibit 4.21).	8-K	000-26497	12/03/09	4.2	
4.16	Second Lien Security Agreement, dated as of December 1, 2009, among Salem Communications Corporation, the subsidiary guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Collateral Agent.	8-K	000-26497	12/03/09	4.3	
4.17	Registration Rights Agreement, dated as of December 1, 2009, among Salem Communications Corporation, the subsidiary guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Collateral Agent and Banc of America Securities LLC, as Representative of the Initial Purchasers.	8-K	000-26497	12/03/09	4.4	
4.18	Third Supplemental Indenture, dated as of November 30, 2009, among Salem Communications Holding Corporation, the subsidiary guarantors party thereto and The Bank of New York Mellon Trust Company, N.A., as Trustee.	8-K	000-26497	12/03/09	4.5	
10.01.01	Employment Agreement, dated July 1, 2004, between Salem Communications Holding Corporation and Edward G. Atsinger III.	10-Q	000-26497	08/06/04	10.01.01	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.01.02	Employment Agreement, dated July 1, 2007, between Salem Communications Holding Corporation and Edward G. Atsinger III.	8-K	000-26497	06/26/07	10.2	
10.01.03	Employment Agreement, dated July 1, 2010 between Salem Communications Holding Corporation and Edward G. Atsinger III.	8-K	000-26497	6/8/10	99.1	
10.01.04	Employment Agreement, dated July 1, 2010 between Salem Communications Holding Corporation and Edward G. Atsinger III.	10-Q	000-26497	6/8/10	99.1	
10.02.01	Employment Agreement, dated July 1, 2004, between Salem Communications Holding Corporation and Stuart W. Epperson.	10-Q	000-26497	08/06/04	10.02.01	
10.02.02	Employment Agreement, dated July 1, 2007, between Salem Communications Holding Corporation and Stuart W. Epperson.	8-K	000-26497	06/26/07	10.1	
10.02.03	Employment Agreement, dated July 1, 2010 between Salem Communications Holding Corporation and Stuart W. Epperson.	8-K	000-26497	2/22/10	99.1	
10.02.04	Employment Agreement, dated July 1, 2010 between Salem Communications Holding Corporation and Stuart W. Epperson.	10-Q	000-26497	2/22/10	99.1	
10.02.05	Employment Agreement, dated July 1, 2011 between Salem Communications Holding Corporation and Stuart W. Epperson.	8-K	000-26497	06/22/11	99.1	
10.02.06	Employment Agreement, dated July 1, 2012 between Salem Communications Holding Corporation and Stuart W. Epperson.					X
10.03.01	Employment Agreement, dated July 1, 2007, between Salem Communications Holding Corporation and Eric H. Halvorson.	8-K	000-26497	06/26/07	10.3	
10.04.01	Employment Agreement, effective as of September 1, 2005, between Salem Communications Holding Corporation and Joe D. Davis.	8-K/A	000-26497	05/25/05	99.1	
10.04.02	Employment Agreement, effective as of July 1, 2007, between Salem Communications Holding Corporation and Joe D. Davis.	8-K	000-26497	06/26/07	10.4	
10.05.01	Employment Agreement, effective as of September 1, 2005, between Salem Communications Holding Corporation and David A.R. Evans.	8-K	000-26497	09/27/05	99.1	
10.05.02	Employment Agreement, effective as of September 15, 2008, between Salem Communications Holding Corporation and David A.R. Evans.	8-K	000-26497	09/09/08	99.1	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.05.03	Employment Agreement, effective as of September 15, 2011, between Salem Communications Holding Corporation and David A.R. Evans.	8-K	000-26497	06/22/11	99.2	
10.06.01	Antenna/tower/studio lease between Common Ground Broadcasting, Inc. (KKMS-AM/Eagan, Minnesota) and Messrs. Atsinger and Epperson expiring in 2016.	S-4	333-41733-29	01/29/98	10.05.04	
10.06.03	Antenna/tower lease (KFAX-FM/Hayward, California) and Salem Broadcasting Company, a partnership consisting of Messrs. Atsinger and Epperson, expiring in 2013.	S-4	333-41733-29	01/29/98	10.05.06	
10.06.04	Antenna/tower lease between Inspiration Media, Inc. (KGNW-AM/Seattle, Washington) and Messrs. Atsinger and Epperson expiring in 2012.	S-4	333-41733-29	01/29/98	10.05.08	
10.06.05	Antenna/tower lease between Inspiration Media, Inc. (KLFE-AM/Seattle, Washington) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring in 2014.	S-4	333-41733-29	01/29/98	10.05.09	
10.06.06	Antenna/tower/studio lease between Pennsylvania Media Associates, Inc. (WNTP-AM/WFIL-AM/Philadelphia, Pennsylvania) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2014.	S-4	333-41733-29	01/29/98	10.05.11.02	
10.06.07	Antenna/tower lease between New Inspiration Broadcasting Co., Inc.: as successor in interest to Radio 1210, Inc. (KPRZ-AM/San Marcos, California) and The Atsinger Family Trust expiring in 2028.	S-4	333-41733-29	01/29/98	10.05.12	
10.06.08	Antenna/tower lease between Salem Media of Texas, Inc. (KSLR-AM/San Antonio, Texas) and Atsinger Family Trust/Epperson Family Limited Partnership expiring 2009.	10-K	000-26497	03/30/00	10.05.13	
10.06.09	Antenna/tower lease between Salem Media of Colorado, Inc. (KNUS-AM/Denver-Boulder, Colorado) and Messrs. Atsinger and Epperson expiring 2016.	S-4	333-41733-29	01/29/98	10.05.15	
10.06.10	Antenna/tower lease between Salem Media of Colorado, Inc. and Atsinger Family Trust/Epperson Family Limited Partnership (KRKS-AM/KBJD-AM/Denver, Colorado) expiring 2009.	10-K	000-26497	03/30/00	10.05.16	
10.06.11	Antenna/tower lease between Salem Media of Oregon, Inc. (KPDQ-AM/FM/Portland, Oregon), and Messrs. Atsinger and Epperson expiring 2012.	S-4	333-41733-29	01/29/98	10.05.17.02	
10.06.12	Antenna/tower lease between Salem Media of Pennsylvania, Inc. (WORD-FM/WPIT-AM/Pittsburgh, Pennsylvania) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2013.	S-4	333-41733-29	01/29/98	10.05.18	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.06.13	Antenna/tower lease between Salem Media of Texas, Inc. (KSLR-AM/San Antonio, Texas) and Epperson-Atsinger 1983 Family Trust expiring 2017.	S-4	333-41733-29	01/29/98	10.05.19	
10.06.13.01	Amendment to Lease to Antenna/tower lease between Salem Media of Texas, Inc. (KSLR-AM/San Antonio, TX) and Epperson-Atsinger 1983 Family Trust expiring 2017.	10-K	000-26497	03/17/08	10.06.13.01	
10.06.13.02	Second Amendment to Lease to Antenna/tower lease between Salem Media of Texas, Inc. (KSLR-AM/San Antonio, TX) and Epperson-Atsinger 1983 Family Trust expiring 2017.	10-K	000-26497	03/17/08	10.06.13.02	
10.06.14	Antenna/tower lease between South Texas Broadcasting, Inc. (KNTH-AM/Houston-Galveston, Texas) and Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2015.	S-4	333-41733-29	01/29/98	10.05.20	
10.06.15	Antenna/tower lease between New Inspiration Broadcasting Co., Inc. successor in interest to Vista Broadcasting, Inc. (KFIA-AM/Sacramento, California) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2016.	S-4	333-41733-29	10/29/98	10.05.21	
10.06.17	Antenna/tower lease between Inspiration Media of Texas, Inc. (KTEK-AM/Alvin, Texas) and the Atsinger Family Trust and The Stuart W. Epperson Revocable Living Trust expiring 2018.	10-K 405	000-26497	03/31/99	10.05.23	
10.06.18	Studio building lease between Salem Radio Properties, Inc. and Thomas H. Moffit Jr.	10-K	000-26497	03/31/06	10.05.24	
10.06.19	Antenna/tower lease between Pennsylvania Media Associates Inc. (WTLN-AM/ Orlando, Florida) and Atsinger Family Trust and Stuart W. Epperson, revocable living trust expiring 2045.	10-K	000-26497	03/16/07	10.05.25	
10.06.20	Lease Agreement, dated April 8, 2008, between Inspiration Media, Inc. (KDOW-AM/Palo Alto, CA) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.20	
10.06.21	Lease Agreement, dated April 8, 2008, between New Inspiration Broadcasting Company, Inc. (KFAX-AM/San Francisco, CA) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.21	
10.06.22	Lease Agreement, dated April 8, 2008, between Inspiration Media, Inc. (KLFE-AM/Seattle, WA) and Principal Shareholders expiring 2023	8-K	000-26497	04/14/08	10.06.22	
10.06.23	Lease Agreement, dated April 8, 2008, between South Texas Broadcasting, Inc. (KNTH-AM/Houston, TX) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.23	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.06.24	Lease Agreement, dated April 8, 2008, between Salem Media of Oregon, Inc. (KPDQ-AM/Portland, OR) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.24	
10.06.25	Lease Agreement, dated April 8, 2008, between Common Ground Broadcasting, Inc. (KPXQ-AM/Glendale, AZ) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.25	
10.06.26	Lease Agreement, dated April 8, 2008, between Salem Media of Texas, Inc. (KSLR-AM/San Antonio, TX) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.26	
10.06.27	Lease Agreement, dated April 8, 2008, between Pennsylvania Media Associates, Inc. (WFIL-AM and WNTP-AM/Philadelphia, PA) and Principal Shareholders expiring 2023.	8-K	000-26497	04/14/08	10.06.27	
10.07.01	Asset Purchase Agreement, dated August 18, 2006, by and between Caron Broadcasting, Inc. and Chesapeake-Portsmouth Broadcasting Corporation (WJGR-AM, Jacksonville, Florida, and WZNZ-AM, Jacksonville, Florida).	10-Q	000-26497	11/09/06	10.06.02	
10.07.02	Asset Purchase Agreement, dated September 14, 2006, by and between Caron Broadcasting, Inc. and Chesapeake-Portsmouth Broadcasting Corporation (WZAZ-AM, Jacksonville, Florida).	10-Q	000-26497	11/09/06	10.06.03	
10.07.03	Local Programming and Marketing Agreement, dated September 14, 2006, by and between Caron Broadcasting, Inc. and Chesapeake-Portsmouth Broadcasting Corporation (WJGR-AM, Jacksonville, Florida, and WZNZ-AM, Jacksonville, Florida).	10-Q	000-26497	11/09/06	10.06.04	
10.07.04	Local Programming and Marketing Agreement, dated September 14, 2006, by and between Caron Broadcasting, Inc. and Chesapeake-Portsmouth Broadcasting Corporation (WZAZ-AM, Jacksonville, Florida).	10-Q	000-26497	11/09/06	10.06.05	
10.08.01	Amended and Restated 1999 Stock Incentive Plan (incorporated by reference to previously filed Appendix B).	DEF 14A	000-26497	04/29/03	Appendix B	
10.08.02	Form of stock option grant for Amended and Restated 1999 Stock Incentive Plan.	10-K	000-26497	03/16/05	10.08.02	
10.08.03	Form of restricted stock option grant for Amended and Restated 1999 Stock Incentive Plan.	10-Q	000-26497	11/09/05	10.01	
10.08.04	Amended and Restated 1999 Stock Incentive Plan as amended and restated through May 18, 2005.	DEF 14A	000-26497	04/18/05	Proposal No. 2	
10.08.04.01	Amended and Restated 1999 Stock Incentive Plan as amended and restated through June 3, 2009.	8-K	000-26497	06/09/09	10.08.04.01	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.09	Management Services Agreement by and among Salem and Salem Communications Holding Corporation, dated August 25, 2000 (incorporated by reference to previously filed exhibit 10.11).	10-Q	000-26497	05/15/01	10.11	
10.10.01	Employment Agreement dated January 1, 2008, between Salem Communications Holding Corporation and Evan D. Masyr.	8-K	000-26497	12/19/07	99.1	
10.11	Intercreditor Agreement dated as of December 1, 2009, among Salem Communications Corporation, the subsidiary guarantors party thereto, Bank of America, N.A., as first lien agent and control agent and the Collateral Agent.	8-K	000-26497	12/03/09	10.1	
10.12.01	Credit Agreement, dated as of December 1, 2009, by and among Salem Communications Corporation, as the borrower, Bank of America, N.A., as Administrative Agent, Swingline Lender, L/C Issuer and a Lender, the other Lenders party thereto, Banc of America Securities LLC, as Joint Lead Arranger and Sole Book Manager, Barclays Capital and ING Capital LLC, as Joint Lead Arrangers, Barclays Capital, as Syndication Agent, and ING Capital LLC, as Documentation Agent.	8-K	000-26497	12/03/09	10.2	
10.12.02	Amendment No. 1 and Waiver to Credit Agreement dated as of November 1, 2010, among Salem Communications Corporation, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and each lender party thereto.	8-K	000-26497	11/14/10	99.2	
10.12.03	Second Amendment to the Credit Agreement dated as of November 15, 2011 by and between Salem Communications Corporation and Wells Fargo Bank, N.A.	8-K	000-26497	11/21/11	10.1	
10.13	First Lien Security Agreement, dated as of December 1, 2009, by and among Salem Communications Corporation, the subsidiary guarantors party thereto and Bank of America, N.A., as Administrative Agent.	8-K	000-26497	12/03/09	10.3	
10.14	Increase Joinder dated as of November 1, 2010 among Salem Communications Corporation, Wells Fargo Bank, National Association, the Guarantors party thereto, and Bank of America, N.A., as Administrative Agent.	8-K	000-26497	11/4/10	99.1	
10.15	Employment Agreement with Evan D. Masyr dated as of January 1, 2011.	8-K	000-26497	12/13/10	99.1	
10.16	Affiliate Line of Credit , dated as of November 17, 2011 between Salem Communications Corporation and Edward G. Atsinger III.	10-K	000-26497	03/9/12	10.16	

Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.17	Affiliate Line of Credit, dated as of November 17, 2011 between Salem Communications Corporation and Stuart W. Epperson.	10-K	000-26497	03/9/12	10.16	
10.18.01	Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, SunTrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	10-Q	000-26497	11/06/03	4.09	
10.18.02	Amendment #1, dated as of May 19, 2004, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, SunTrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	10-Q	000-26497	08/06/04	4.11	
10.18.03	Amendment #2, dated as of July 7, 2005, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, SunTrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	8-K	000-26497	07/13/05	4.12	
10.18.04	Consent No. 2, dated as of July 23, 2003, under the Fourth Amended and Restated Credit Agreement between Salem Communications Corporation and its guarantors, and The Bank of New York.	10-Q	000-26497	08/06/03	4.26	
10.18.05	Amendment #3, dated as of June 9, 2006, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, SunTrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	8-K	000-26497	06/15/06	4.13	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.18.06	Amendment #4, dated as of October 24, 2007, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, SunTrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	8-K	000-26497	10/30/07	4.19	
10.18.07	Amendment #5, dated as of March 11, 2009, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, Sun Trust Bank, as Syndication Agent, Bank of America, N.A. (successor by merger to Fleet National Bank), as Documentation Agent, ING Capital, LLC, as Documentation Agent, The Bank of New York Mellon (formerly the Bank of New York), as Administrative Agent, and the Lenders party thereto.	8-K	000-26497	03/12/09	99.1	
10.19	Affiliate Line of Credit dated as of May 1, 2012 between Salem Communications Corporation and Roland S. Hinz.	10-Q	000-26497	08/09/12	10.19	
10.19.01	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	
10.20.01	Business Loan Agreement dated as of May 21, 2012 between Salem Communications Corp. and First California Bank.	10-Q	000-26497	08/09/12	10.20.01	
10.20.02	Promissory Note dated May 21, 2012 between Salem Communications Corporation and First California Bank.	10-Q	000-26497	08/09/12	10.20.02	
10.20.03	Subordination Agreement dated as of May 21, 2012 between Salem Communications Corporation, First California Bank and Wells Fargo Bank, National Association.	10-Q	000-26497	08/09/12	10.20.03	
10.20.04	Subordination Agreement dated as of May 21, 2012 between Salem Communications Corporation, Edward G. Atsinger III and Wells Fargo Bank, National Association.	10-Q	000-26497	08/09/12	10.20.04	
10.20.05	Subordination Agreement dated as of May 21, 2012 between Salem Communications Corporation, Stuart W. Epperson and Wells Fargo Bank, National Association.	10-Q	000-26497	08/09/12	10.20.05	
10.20.06	Subordination Agreement dated as of May 21, 2012 between Salem Communications Corporation, Roland Hinz and Wells Fargo Bank, National Association.	10-Q	000-26497	08/09/12	10.20.06	
10.20.07	Commercial Guaranty dated May 21, 2012 between Salem Communications Corporation, Atsinger Family Trust and First California Bank.	10-Q	000-26497	08/09/12	10.20.07	

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Exhibit Number	Exhibit Description	Form	File No.	Date of First Filing	Exhibit Number	Filed Herewith
10.20.08	Commercial Guaranty dated May 21, 2012 between Salem Communications Corporation, Edward G. Atsinger III and First California Bank.	10-Q	000-26497	08/09/12	10.20.08	
10.20.09	Commercial Guaranty dated May 21, 2012 between Salem Communications Corporation, The Stuart W. Epperson Revocable Living Trust under agreement dated January 14, 1993, as amended and First California Bank.	10-Q	000-26497	08/09/12	10.20.09	
10.20.10	Commercial Guaranty dated May 21, 2012 between Salem Communications Corporation, Stuart W. Epperson and First California Bank.	10-Q	000-26497	08/09/12	10.20.10	
16.01	Letter from Ernst & Young LLP regarding change in certifying accountant.	8-K	000-26497	06/12/07	16.1	
21.01	Subsidiaries of Salem Communications Corporation.					X
23.1	Consent of SingerLewak LLP, Independent Registered Public Accounting Firm.					X
23.3	Consent of Bond & Pecaro, Inc., dated February 5, 2013.					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 Annual Report on Form 10K for the fiscal year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Balance Sheets (ii) Consolidated Statements of Operations (iii) the Consolidated Statement of Stockholders Equity (iv) the Consolidated Statements of Cash Flows (v) the Notes to the Consolidated Financial Statements.					X

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	SALEM COMMUNICATIONS CORPORATION
March 1, 2013	By: /s/ EDWARD G. ATSINGER III Edward G. Atsinger III Chief Executive Officer
March 1, 2013	By: /s/ EVAN D. MASYR Evan D. Masyr Senior Vice President and Chief Financial Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ EDWARD G. ATSINGER III	Chief Executive Officer	March 1, 2013
Edward G. Atsinger III	(Principal Executive Officer)	
/s/ EVAN D. MASYR	Senior Vice President and Chief Financial Officer	March 1, 2013
Evan D. Masyr	(Principal Financial Officer and Principal Accounting Officer)	
/s/ STUART W. EPPERSON	Chairman	March 1, 2013
Stuart W. Epperson		
/s/ DAVID DAVENPORT	Director	March 1, 2013
David Davenport		
/s/ ROLAND S. HINZ	Director	March 1, 2013
Roland S. Hinz		
/s/ JONATHAN VENVERLOH	Director	March 1, 2013
Jonathan Venverloh		
/s/ RICHARD A. RIDDLE	Director	March 1, 2013
Richard A. Riddle		
/s/ DENNIS M. WEINBERG	Director	March 1, 2013
Dennis M. Weinberg		
/s/ FRANK WRIGHT	Director	March 1, 2013
Frank Wright		

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EXHIBIT INDEX

Exhibit Number	Description of Exhibits
10.02.06	Employment Agreement, dated July 1, 2012 between Salem Communications Holding Corporation and Stuart W. Epperson.
21.01	Subsidiaries of Salem Communications Corporation.
23.1	Consent of SingerLewak LLP, Independent Registered Public Accounting Firm.
23.3	Consent of Bond & Pecaro, Inc.
31.1	Certification of Edward G. Atsinger III Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.
31.2	Certification of Evan D. Masyr Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.
32.1	Certification of Edward G. Atsinger III Pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Evan D. Masyr Pursuant to 18 U.S.C. Section 1350.
101	The following financial information from the Annual Report on Form 10K for the fiscal year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Balance Sheets (ii) Consolidated Statements of Operations (iii) the Consolidated Statement of Stockholders Equity (iv) the Consolidated Statements of Cash Flows (v) the Notes to the Consolidated Financial Statements.