SALEM COMMUNICATIONS CORP /DE/
Form 10-Q
August 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES AND EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM __________________ TO __________________

COMMISSION FILE NUMBER 000-26497

SALEM COMMUNICATIONS CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**77-0121400** (I.R.S. EMPLOYER IDENTIFICATION NUMBER)
4880 SANTA ROSA ROAD **CAMARILLO, CALIFORNIA** (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	**93012** (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (805) 987-0400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X]   No [   ]

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

Large accelerated filer [   ]   Accelerated filer [X]   Non-accelerated filer [   ]

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

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

Class A Common Stock, $0.01 par value per share	Outstanding at August 3, 2007 18,296,324 shares
Class B Common Stock, $0.01 par value per share	Outstanding at August 3, 2007 5,553,696 shares

SALEM COMMUNICATIONS CORPORATION

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FORWARD–LOOKING STATEMENTS

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

PART I - FINANCIAL INFORMATION

SALEM COMMUNICATIONS CORPORATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)

	December 31, 2006 (Note 1)	June 30, 2007 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 710	**$ 752**
Trade accounts receivable (net of allowance for doubtful accounts of $7,606 in 2006 and $7,454 in 2007)	31,984	**31,335**
Other receivables	551	**581**
Prepaid expenses	2,330	**2,416**
Income tax receivable	—	**39**
Deferred income taxes	5,020	**5,009**
Total current assets	40,595	**40,132**
Property, plant and equipment (net of accumulated depreciation of $74,766 in 2006 and $78,493 in 2007)	128,713	**130,808**
Broadcast licenses	476,544	**472,463**
Goodwill	20,606	**20,463**
Other indefinite-lived intangible assets	2,892	**2,892**
Amortizable intangible assets (net of accumulated amortization of $10,846 in 2006 and $12,433 in 2007)	8,368	**7,098**
Bond issue costs	593	**518**
Bank loan fees	2,996	**2,488**
Fair value of interest rate swap agreements	1,290	**2,663**
Other assets	3,667	**4,449**
Total assets	$ 686,264	**$ 683,974**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,421	**$ 1,496**
Accrued expenses	6,446	**6,264**
Accrued compensation and related expenses	7,033	**7,412**
Accrued interest	4,275	**2,252**
Deferred revenue	4,050	**4,565**
Current portion of long-term debt and capital lease obligations	2,048	**3,683**
Income taxes payable	22	**—**
Total current liabilities	27,295	**25,672**
Long-term debt and capital lease obligations, less current portion	358,978	**344,951**
Deferred income taxes	53,935	**60,810**
Deferred revenue	7,063	**7,303**
Other liabilities	1,277	**1,204**
Total liabilities	448,548	**439,940**
Commitments and contingencies		
Stockholders' equity:		
Class A common stock, $0.01 par value; authorized 80,000,000 shares; 20,424,242 issued and 18,293,824 outstanding at December 31, 2006 and	204	**204**

20,426,742 issued and 18,296,324 outstanding at June 30, 2007		
Class B common stock, $0.01 par value; authorized 20,000,000 shares; 5,553,696 issued and outstanding shares at December 31, 2006 and June 30, 2007	56	**56**
Additional paid-in capital	221,466	**223,131**
Retained earnings	47,433	**51,262**
Treasury stock, at cost (2,130,418 shares at December 31, 2006 and June 30, 2007)	(32,218)	**(32,218)**
Accumulated other comprehensive income	775	**1,599**
Total stockholders’ equity	237,716	**244,034**
Total liabilities and stockholders’ equity	$ 686,264	**$ 683,974**

See accompanying notes

SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except share and per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2007**	2006	**2007**
Net broadcasting revenue	$ 53,381	**$ 53,650**	$ 102,155	**$ 104,090**
Non-broadcast revenue	4,684	**6,388**	7,936	**12,042**
Total revenue	58,065	**60,038**	110,091	**116,132**
Operating expenses:				
Broadcasting operating expenses, exclusive of depreciation and amortization shown below (including $337 and $307 for the quarter ended June 30, 2006 and 2007, respectively, and $614 and $617 for the six months ended June 30, 2006 and 2007, respectively, paid to related parties)	33,498	**33,629**	65,192	**66,112**
Non-broadcast operating expenses, exclusive of depreciation and amortization shown below	3,827	**5,652**	7,259	**10,923**
Corporate expenses, exclusive of depreciation and amortization shown below (including $52 and $76 for the quarter ended June 30, 2006 and 2007, respectively, and $150 and $145 for the six months ended June 30, 2006 and 2007, respectively, paid to related parties)	6,256	**5,496**	12,696	**11,310**
Depreciation (including $138 and $150 for the quarter ended June 30 2006 and 2007, respectively, and $225 and $289 for the six months ended June 30, 2006 and 2007, respectively for non-broadcast businesses)	3,113	**2,923**	5,858	**6,014**

Amortization (including $525 and $748 for the quarter ended June 30 2006 and 2007, respectively, and $842 and $1,486 for the six months ended June 30, 2006 and 2007, respectively for non-broadcast businesses)	753	**776**	1,303	**1,586**
(Gain) loss on disposal of assets	(15,510)	**634**	(19,039)	**(2,635)**
Total operating expenses	31,937	**49,110**	73,269	**93,310**
Operating income from continuing operations	26,128	**10,928**	36,822	**22,822**
Other income (expense):				
Interest income	—	**48**	46	**108**
Interest expense	(6,779)	**(6,308)**	(13,367)	**(12,762)**
Other income (expense), net	(174)	**182**	(346)	**147**
Income from continuing operations before income taxes	19,175	**4,850**	23,155	**10,315**
Provision for income taxes	7,584	**1,926**	9,178	**4,426**
Income from continuing operations	11,591	**2,924**	13,977	**5,889**
Income (loss) from discontinued operations, net of tax	(25)	**—**	304	**—**
Net income	$ 11,566	**$ 2,924**	$ 14,281	**$ 5,889**
Other comprehensive income, net of tax	894	**1,112**	1,930	**824**
Comprehensive income	$ 12,460	**$ 4,036**	$ 16,211	**$ 6,713**
Basic earnings per share from continuing operations	$ 0.48	**$ 0.12**	$ 0.57	**$ 0.25**
Income per share from discontinued operations	—	**—**	0.01	**—**
Basic earnings per share	$ 0.48	**$ 0.12**	$ 0.58	**$ 0.25**
Diluted earnings per share from continuing operations	$ 0.48	**$ 0.12**	$ 0.57	**$ 0.25**
Income (loss) per share from discontinued operations	**—**	**—**	0.01	**—**
Diluted earnings per share	$ 0.47	**$ 0.12**	$ 0.58	**$ 0.25**
Basic weighted average shares outstanding	24,347,520	**23,850,020**	24,516,432	**23,849,312**
Diluted weighted average shares outstanding	24,356,275	**23,855,967**	24,525,718	**23,854,518**

See accompanying notes

SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30, 2006	**2007**
OPERATING ACTIVITIES		
Income from continuing operations	$ 13,977	**$ 5,889**
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Non-cash stock-based compensation	2,620	**1,634**
Depreciation and amortization	7,161	**7,600**
Amortization of bond issue costs and bank loan fees	535	**583**
Amortization and accretion of financing items	(252)	**58**
Provision for bad debts	1,699	**1,173**
Deferred income taxes	9,160	**4,277**
(Gain) loss on disposal of assets	(19,039)	**(2,635)**
Changes in operating assets and liabilities:		
Accounts receivable	(1,106)	**(593)**
Prepaid expenses and other current assets	(146)	**(86)**
Accounts payable and accrued expenses	2,565	**(2,673)**
Deferred revenue	1,078	**755**
Other liabilities	(189)	**28**
Income taxes payable	157	**(22)**
Net cash provided by continuing operating activities	18,220	**15,988**
INVESTING ACTIVITIES		
Capital expenditures	(11,258)	**(8,788)**
Purchases of broadcast assets	(19,229)	**—**
Purchase of non-broadcast businesses	(10,509)	**(311)**
Proceeds from sale of property, plant and equipment	2,106	**7,963**
Other	(206)	**(649)**
Net cash used in investing activities of continuing operations	(39,096)	**(1,785)**
FINANCING ACTIVITIES		
Proceeds from borrowings under credit facilities	35,000	**2,793**
Repurchase of Class A common stock	(15,149)	**—**
Payments of long-term debt and notes payable	(2,002)	**(15,991)**
Proceeds from exercise of stock options	24	**30**
Tax benefit related to stock options exercised	1	**1**
Payments on capital lease obligations	(14)	**(21)**
Book overdraft	—	**(973)**
Net cash provided by (used in) financing activities	17,860	**(14,161)**
CASH FLOWS OF DISCONTINUED OPERATIONS		
Operating cash flows	(231)	**—**
Investing cash flows	(2)	**—**
Total cash outflow from discontinued operations	(233)	**—**
Net increase (decrease) in cash and cash equivalents	(3,249)	**42**
Cash and cash equivalents at beginning of year	3,979	**710**
Cash and cash equivalents at end of period	$ 730	**$ 752**
Supplemental disclosures of cash flow information:		
Cash paid during the period for		

Interest	$	12,459	**$**	**10,739**
Income taxes	$	76	**$**	**215**
Non-cash investing and financing activities:				
Assets acquired through capital lease obligations	$	—	$	**800**

See accompanying notes

SALEM COMMUNICATIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of Salem Communications Corporation ("Salem" or the "Company") include the Company and its wholly-owned subsidiaries. The Company, excluding its subsidiaries, is herein referred to as Parent. All significant intercompany balances and transactions have been eliminated.

Information with respect to the three and six months ended June 30, 2007 and 2006 is unaudited. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the unaudited interim financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended December 31, 2006.

The balance sheet at December 31, 2006 included in this report has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP.

NOTE 2. RECLASSIFICATIONS

Certain reclassifications were made to the prior period financial statements to conform to the current period presentation.

NOTE 3. ACQUISITIONS AND OTHER SIGNIFICANT TRANSACTIONS

On February 2, 2007, the Company purchased ChristianMusicPlanet.com, a leading Christian music web portal for $0.3 million. The purchase price was allocated to the assets acquired as follows:

	Amount *(Dollars in thousands)*
Asset	
Domain names	$ 268
Customer lists and contracts	32
Goodwill	11
	$ 311

On February 7, 2007, the Company sold radio station WKNR-AM in Cleveland, Ohio, to Good Karma Broadcasting for $7.0 million resulting in a pre-tax gain of $3.4 million. The operating results of WKNR-AM were excluded from our Condensed Consolidated Statement of Operations beginning on December 1, 2006, the date the Company stopped operating the station pursuant to a local marketing agreement ("LMA") with Good Karma Broadcasting.

On May 29, 2007, the Company sold radio station WVRY-FM, Nashville, Tennessee to Grace Broadcasting Services, Inc. for $0.9 million resulting in a pre-tax loss of $0.5 million. The operating results of WVRY-FM were excluded from our Condensed Consolidated Statement of Operations beginning on March 9, 2007, the date the Company stopped operating the station pursuant to an LMA with Grace Broadcasting Services.

Other Pending Transactions:

On February 1, 2007, the Company entered into an LMA to operate radio station KKSN-AM, in Portland, Oregon. The accompanying Condensed Consolidated Statement of Operations includes the operating results of this radio station as of the LMA date. The Company entered an agreement to purchase KKSN-AM, subject to certain conditions, for $4.5 million. We do not expect this sale to close during 2007.

Discontinued Operations:

The following table sets forth the components of income (loss) from discontinued operations, net of tax, for the three and six months ended June 30, 2006 (dollars in thousands).

	Three Months Ended June 30, 2006		Six Months Ended June 30, 2006	
Operating loss	$	(18)	$	(160)
Gain (loss) on sale or exchange of radio stations		(11)		656
Gain (loss) from discontinued operations before income taxes		(29)		496
Provision (benefit) for (from) income taxes		(4)		192
Income (loss) from discontinued operations, net of tax	$	(25)	$	304

Details of these transactions are as follows:

On February 10, 2006, the Company exchanged radio stations WTSJ-AM, Cincinnati, Ohio, and WBOB-AM, Cincinnati, Ohio and $6.7 million in cash for selected assets of radio station WLQV-AM, Detroit, Michigan. The accompanying Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 reflect the results of WTSJ-AM and WBOB-AM as discontinued operations. The exchange was accounted for under Statement of Financial Accounting Standards (“SFAS”) No. 153, “Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29,” and resulted in a pre-tax gain on the exchange of $0.7 million.

On July 17, 2006, the Company completed the sale of radio station WBTK-AM, Richmond, Virginia, for $1.5 million resulting in a pre-tax gain of $0.6 million. The accompanying Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 reflect the results of WBTK-AM as a discontinued operation.

On September 18, 2006, the Company completed the sale of radio station WBGB-FM, Jacksonville, Florida for $7.6 million resulting in a pre-tax gain of $0.8 million. The accompanying Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 reflect the results of WBGB-FM as a discontinued operation.

On December 1, 2006, the Company completed the sale of radio stations WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida for $2.8 million resulting in a pre-tax gain of $0.1 million. The assets were sold to Chesapeake-Portsmouth Broadcasting Corporation (“Chesapeake-Portsmouth”). Chesapeake-Portsmouth is a company controlled by Nancy Epperson, wife of Salem's Chairman of the Board Stuart W. Epperson and sister of Salem’s CEO Edward G. Atsinger III. The accompanying Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 reflect the results of WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida as discontinued operations.

On December 22, 2006, the Company completed the sale of radio station WITH-AM, Baltimore, Maryland for $3.0 million resulting in a pre-tax gain of $2.2 million. The accompanying Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 reflect the results of WITH-AM as a discontinued operation.

NOTE 4. STOCK-BASED COMPENSATION

The Company has one stock incentive plan. The Amended and Restated 1999 Stock Incentive Plan (the "Plan") allows the Company to grant stock options to employees, directors, officers and advisors of the Company. A maximum of 3,100,000 shares are authorized under the Plan. Options generally vest over a four year period and have a maximum term of five years from the vesting date. The Plan provides that vesting may be accelerated in certain corporate transactions of the Company. The Plan provides that the Board of Directors, or a committee appointed by the Board, has discretion, subject to certain limits, to modify the terms of outstanding options. In accordance with SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"), the Company recognizes compensation expense related to the estimated fair value of stock options granted.

The Company adopted SFAS No. 123(R) on January 1, 2006, using the modified-prospective-transition method. Under this transition method, compensation expense recognized subsequent to adoption includes: (a) compensation expense for all share-based awards granted prior to, but not yet vested, as of December 31, 2005 based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and (b) compensation expense for all share-based awards granted subsequent to December 31, 2005, based on the grant-date fair values estimated in accordance with the provisions of SFAS No. 123(R). In accordance with the modified-prospective-transition method, the Company's results of operations for prior periods have not been adjusted to reflect the impact of SFAS 123(R).

The following table reflects the components of stock-based compensation expense recognized in our Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2007**	2006	**2007**
	(Dollars in thousands)			
Stock option compensation expense included in corporate expenses	$ 1,101	**$ 591**	$ 2,174	**$ 1,098**
Restricted stock units compensation expense included in corporate expenses	22	**16**	44	**32**
Stock option compensation expense included in broadcast operating expenses	166	**230**	373	**437**
Stock option compensation expense included in non-broadcast operating expenses	23	**43**	29	**67**
Total stock-based compensation expense	$ 1,312	**$ 880**	$ 2,620	**$ 1,634**
Tax benefit from stock-based compensation expense	(520)	**(378)**	(1,044)	**(723)**
Total stock-based compensation expense net of tax benefit	$ 792	**$ 502**	$ 1,576	**$ 911**

Employee stock option and restricted stock grants

The Plan provides for grants of stock options to employees. The option exercise price is set at the closing price of our common stock on the date of grant, and the related number of shares granted is fixed at that point in time. Grants of equity instruments generally vest over a four year period. Stock option awards expire five years from the date of vesting. The Plan also provides for grants of restricted stock and restricted stock units. Eligible employees may receive stock options units 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 received restricted stock units that vest one year from the date of issuance, in addition to stock options that vest one year from the date of issuance.

The Company uses the Black-Scholes option valuation model to estimate the grant date fair value of stock options. The expected volatility calculation reflect the historical volatility of the Company stock as determined by the closing price over a six to nine year term that is generally commensurate with the contractual term of the option. Upon the adoption of SFAS No. 123(R) the expected term of the option is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rates for periods within the expected life of the option are based on the U.S. Treasury yield curve in effect during the period the options were granted. The weighted-average assumptions used to estimate the fair value of the stock options using the Black-Scholes option valuation model were as follows for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2007**	2006	**2007**
Expected volatility	50.65%	**43.88%**	52.1%	**43.65%**
Expected dividends	0.0%	**0.0%**	0.0%	**0.0%**
Expected term (in years)	6 - 9	**6 - 9**	6 - 9	**6 - 9**
Risk-free interest rate	5.09%	**4.83%**	4.97%	**4.70%**

Stock option information with respect to our stock-based compensation plans during the six months ended June 30, 2007 is as follows (dollars in thousands, except per share amounts):

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at January 1, 2007	**2,146,564**	**$ 22.30**			**$ —**
Granted	**388,900**	**11.82**		**$ 6.35**	**—**
Exercised	**(2,500)**	**11.81**			**4,219**
Forfeited or expired	**(83,965)**	**20.98**			**—**
Outstanding at June 30, 2007	**2,448,999**	**$ 20.70**	**4.7 years**		**—**
Exercisable at June 30, 2007	**1,416,062**	**$ 24.35**	**3.0 years**		**18,796**

The fair values of shares of restricted stock are determined based on the closing price of the Company common stock on the grant dates. Information regarding our restricted stock unit grants for the six months ended June 30, 2007 is as follows:

Restricted Stock Units	Shares	Weighted Average

			Exercise Price
Non-Vested at January 1, 2007	6,000	$	11.15
Granted	—		—
Vested	—		—
Forfeited	—		—
Non-Vested at June 30, 2007	6,000	$	11.15

As of June 30, 2007, there was $5.9 million of total unrecognized compensation expense related to non-vested awards of stock options and restricted shares.

NOTE 5. OTHER COMPREHENSIVE INCOME

Other comprehensive income reflects changes in the fair value of each of the Company's three cash flow hedges as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2007**	2006	**2007**
	(Dollars in thousands)			
Mark-to-market adjustment	$ 1,489	**$ 1,853**	$ 3,216	**$ 1,373**
Tax Provision (benefit)	595	**741**	1,286	**549**
Other comprehensive income	$ 894	**$ 1,112**	$ 1,930	**$ 824**

NOTE 6. RECENT ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 159

On February 15, 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statements No. 115." SFAS No. 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the "fair value option"). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. SFAS No. 159 is effective beginning January 1, 2008. The Company believes that the adoption of SFAS No. 159 will not have a material impact on the Company's results of operations, cash flows or financial position.

Statement of Financial Accounting Standards No. 157

On September 15, 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, specifies the acceptable methods for determining fair value, and expands disclosure requirements regarding fair value measurements. SFAS No. 157 is effective beginning January 1, 2008. The Company believes that the adoption of SFAS No. 157 will not have a material impact on the Company's results of operations, cash flows or financial position.

NOTE 7. EQUITY TRANSACTIONS

The Company's Board of Directors authorized a $25.0 million share repurchase program in May 2005. In February 2006, the Board of Directors increased Salem's existing share repurchase program to permit the repurchase of up to an additional $25.0 million of shares of Salem's Class A common stock. This repurchase program will continue until the earlier of (a) December 31, 2007, (b) all desired shares are repurchased, or (c) the Repurchase Plan is terminated earlier by the Repurchase Plan Committee on behalf of Salem. The amount the Company may repurchase may be limited by certain restrictions under our credit facilities. As of June 30, 2007, the Company repurchased 2,130,418 shares of stock for $32.2 million at an average price of $15.12 per share. No shares were repurchased during the three and six months ended June 30, 2007.

The Company accounts for stock-based compensation expense in accordance with SFAS No. 123(R). As a result, $0.9 million and $1.6 million of stock-based compensation expense has been recorded to additional paid-in capital for the three and six months ended June 30, 2007, respectively in comparison to $1.3 million and $2.6 million for the three and six months ended June 30, 2006.

NOTE 8. NOTES PAYABLE AND LONG-TERM DEBT

Long-term debt consisted of the following:

	December 31, 2006	**June 30, 2007**
	(Dollars in thousands)	
Term loans under credit facility	$ 238,125	**$ 236,475**
Revolving line of credit under credit facility	19,100	**8,500**
Swingline credit facility	1,241	**293**
7¾% Senior Subordinated Notes due 2010	100,000	**100,000**
Seller financed note to acquire Townhall.com	2,444	**2,502**
Capital leases and other loans	116	**864**
	361,026	**348,634**
Less current portion	2,048	**3,683**
	$ 358,978	**$ 344,951**

Maturities of Long-Term Debt

Principal repayment requirements under all long-term debt agreements outstanding at June 30, 2007 for each of the next five years and thereafter are as follows:

Twelve Months Ended June 30,	Amount
	(Dollars in thousands)
2008	**$ 3,683**
2009	**12,482**
2010	**231,715**
2011	**100,023**
2012	**28**
Thereafter	**703**
	$ 348,634

NOTE 9. AMORTIZABLE INTANGIBLE ASSETS

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

	As of June 30, 2007		
	Cost	Accumulated Amortization	**Net**
		(Dollars in thousands)	
Customer lists and contracts	$ 10,437	$ (6,890)	**$ 3,547**
Domain and brand names	4,771	(2,018)	**2,753**
Favorable and assigned leases	1,581	(1,188)	**393**
Other amortizable intangible assets	2,742	(2,337)	**405**
	$ 19,531	$ (12,433)	**$ 7,098**

	As of December 31, 2006		
	Cost	Accumulated Amortization	Net
		(Dollars in thousands)	
Customer lists and contracts	$ 10,404	$ (6,030)	$ 4,374
Domain and brand names	4,487	(1,533)	2,954
Favorable and assigned leases	1,581	(1,144)	437
Other amortizable intangible assets	2,742	(2,139)	603
	$ 19,214	$ (10,846)	$ 8,368

Based on the amortizable intangible assets as of June 30, 2007, we estimate amortization expense for the next five years to be as follows:

Year Ending	Amortization Expense	
	(Dollars in thousands)	
2007 (July 1 – December 31)	$	1,398
2008		2,533
2009		1,282
2010		832
2011		369
Thereafter		684
Total	$	7,098

NOTE 10. BASIC AND DILUTED EARNINGS PER SHARE

Basic 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 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 2,179,919 and 2,448,999 shares of Class A common stock were outstanding at June 30, 2006 and 2007, respectively. 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. Those options are excluded due to their antidilutive effect.

NOTE 11. DERIVATIVE INSTRUMENTS

Salem is exposed to fluctuations in interest rates. The Company actively monitors these fluctuations and uses derivative instruments from time to time to manage the related risk. In accordance with our risk management strategy, Salem uses 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. The Company’s use of derivative instruments may result in short-term gains or losses that may increase the volatility of Salem’s earnings.

Under SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities”, as amended, the accounting for changes in the fair value of a derivative instrument at each new measurement date is dependent upon its intended use. The change in the fair value of a derivative instrument designated as a hedge of the exposure to changes in the fair value of a recognized asset or liability or a firm commitment, referred to as a fair value hedge, is recognized as gain or loss in earnings in the period of the change together with an offsetting gain or loss for the change in fair value of the hedged item attributable to the risk being hedged. The change in the fair value of a derivative instrument designated as a hedge of the exposure of the variability in expected cash flows of recognized assets, liabilities or of unrecognized forecasted transactions, referred to as a cash flow hedge, is recognized as other comprehensive income. The differential paid or received on the interest rate swaps is recognized in earnings as an adjustment to interest expense.

During 2004 and through February 18, 2005, the Company had an interest rate swap agreement with a notional principal amount of $66.0 million. This agreement related to its $94.4 million 9% senior subordinated notes due 2011 (the “9% Notes.”) This agreement was scheduled to expire in 2011 when the 9% Notes were to mature, and effectively swapped the 9.0% fixed interest rate on $66.0 million of the 9% Notes for a floating rate equal to the LIBOR rate plus 3.09%. On February 18, 2005, the Company sold its entire interest in this swap and received a payment of approximately $3.7 million, which was amortized as a reduction of interest expense over the remaining life of the 9% Notes. Interest expense for the three and six months ended June 30, 2006, was reduced by $0.2 million and $0.3 million, respectively, related to the amortization of the buyout premium received. On July 6, 2006, the Company completed the redemption of the remainder of its outstanding 9% Notes. As a result of the redemption, the Company wrote off the remaining balance of the buyout premium of approximately $2.7 million as a reduction of the loss on the early redemption of long term debt.

During 2004, the Company also had a second interest rate swap agreement with a notional principal amount of $24.0 million. This agreement also related to its 9% Notes. This agreement was to expire in 2011 when the 9% Notes were to mature, and effectively swapped the 9.0% fixed interest rate on $24.0 million of the 9% Notes for a floating rate equal to the LIBOR rate plus 4.86%. On August 20, 2004, the Company sold its interest in $14.0 million of this swap. As a result of this transaction, the Company paid and capitalized $0.3 million in buyout premium, which was to be amortized into interest expense over the remaining life of the 9% Notes. On October 22, 2004, the Company sold its remaining $10.0 million interest in this swap. As a result of this second transaction, the Company paid and capitalized approximately $110,000 in buyout premium, which was to be amortized into interest expense over the remaining life of the 9% Notes. On July 6, 2006, the Company completed the redemption of the remainder of its outstanding 9% Notes. Interest expense for the three and six months ended June 30, 2006, included approximately $16,000 and $33,000, respectively, related to the amortization of the capitalized buyout premium.

On April 8, 2005, the Company entered into an interest rate swap arrangement for the notional principal amount of $30.0 million whereby it will pay a fixed interest rate of 4.99% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the six months ended June 30, 2007, was reduced by approximately $55,000 as a result of the difference between the interest rates. As of June 30, 2007, the Company recorded an asset for the fair value of the interest swap of approximately $0.5 million. This amount, net of income tax benefits of approximately $0.2 million, is reflected in other comprehensive income, as the Company has designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap was July 1, 2006 and the expiration date is July 1, 2012.

On April 26, 2005, the Company entered into a second interest rate swap arrangement for the notional principal amount of $30.0 million whereby it will pay a fixed interest rate of 4.70% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the six months ended June 30, 2007, was reduced by approximately $98,000 as a result of the difference between the interest rates. As of June 30, 2007, the Company recorded an asset for the fair value of the interest swap of approximately $0.9 million. This amount, net of income taxes of approximately $0.4 million, is reflected in other comprehensive income, as the Company has designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap was July 1, 2006 and the expiration date is July 1, 2012.

On May 5, 2005, the Company entered into a third interest rate swap arrangement for the notional principal amount of $30.0 million whereby it will pay a fixed interest rate of 4.53% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the six months ended June 30, 2007, was reduced by approximately $125,000 as a result of the difference between the interest rates. As of June 30, 2007, the Company recorded an asset for the fair value of the interest swap of approximately $1.2 million. This amount, net of income taxes of approximately $0.5 million, is reflected in other comprehensive income, as the Company has designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap was July 1, 2006 and the expiration date is July 1, 2012.

Interest Rate Caps

On October 18, 2006, the Company purchased two interest rate caps for $0.1 million to mitigate exposure to rising interest rates. The first interest rate cap covers $50.0 million of borrowings under the credit facilities for a three year period. The second interest rate cap covers $50.0 million of borrowings under the credit facilities for a four year period. Both interest rate caps are at 7.25%. The caps do not qualify for hedge accounting and accordingly, all changes in fair value have been included as a component of interest expense. Interest expense of approximately $15,000 was recognized during the six months ended June 30, 2007 related to our interest rate caps.

NOTE 12. INCOME TAXES

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS No. 109"). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN No. 48 effective January 1, 2007. In accordance with FIN No. 48, paragraph 19, the Company has decided to classify interest and penalties as a component of tax expense. As a result of the implementation of FIN No. 48, the Company recognized a $2.0 million increase in liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.

The Company files numerous consolidated and separate income tax returns in the United States Federal jurisdiction and in many state jurisdictions. The Company is no longer subject to US Federal income tax examinations for years before 2003 and is no longer subject to state and local, or income tax examinations by tax authorities for years before 2002.

The Company has unrecognized tax benefits of approximately $4.0 million as of January 1, 2007 and, if recognized, would result in a reduction of the Company's effective tax rate. Interest and penalties are immaterial at the date of adoption and are included in the unrecognized tax benefits. The Company recorded an increase of its unrecognized tax benefits of approximately $0.4 million as of June 30, 2007.

NOTE 13. COMMITMENTS AND CONTINGENCIES

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. Also, the Company maintains insurance which 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.

NOTE 14. SEGMENT DATA

SFAS No. 131, "Disclosures About Segments of An Enterprise and Related Information" requires companies to provide certain information about their operating segments. The Company has one reportable operating segment - radio broadcasting. The remaining non-reportable segments consist of Salem Web Network™ and Salem Publishing, which do not meet the reportable segment quantitative thresholds and accordingly are aggregated below as non-broadcast. The radio broadcasting segment also operates various radio networks.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2007**	2006	**2007**
	(Dollars in thousands)			
Net revenue				
Radio broadcasting	$ 53,381	**$ 53,650**	$ 102,155	**$ 104,090**
Non-broadcast	4,684	**6,388**	7,936	**12,042**
Consolidated net revenue	$ 58,065	**$ 60,038**	$ 110,091	**$ 116,132**
Operating expenses before depreciation, amortization and (gain) loss on disposal of assets				
Radio broadcasting	$ 33,498	**$ 33,629**	$ 65,192	**$ 66,112**
Non-broadcast	3,827	**5,652**	7,259	**10,923**
Corporate	6,256	**5,496**	12,696	**11,310**
Consolidated operating expenses before depreciation, amortization and (gain) loss on disposal of assets	$ 43,581	**$ 44,777**	$ 85,147	**$ 88,345**
Operating income from continuing operations before depreciation, amortization and (gain) loss on disposal of assets				
Radio broadcasting	$ 19,883	**$ 20,021**	$ 36,963	**$ 37,978**
Non-broadcast	857	**736**	677	**1,119**
Corporate	(6,256)	**(5,496)**	(12,696)	**(11,310)**
Consolidated operating income from continuing operations before depreciation, amortization and (gain) loss on disposal of assets	$ 14,484	**$ 15,261**	$ 24,944	**$ 27,787**
Depreciation				
Radio broadcasting	$ 2,676	**$ 2,497**	$ 5,050	**$ 5,162**
Non-broadcast	138	**150**	225	**289**
Corporate	299	**276**	583	**563**
Consolidated depreciation expense	$ 3,113	**$ 2,923**	$ 5,858	**$ 6,014**
Amortization				
Radio broadcasting	$ 224	**$ 23**	$ 452	**$ 90**

Non-broadcast		525		**748**		842		**1,486**
Corporate		4		**5**		9		**10**
Consolidated amortization expense	$	753	**$**	**776**	$	1,303	**$**	**1,586**
Operating income from continuing operations before (gain) loss on disposal of assets								
Radio broadcasting	$	16,983	**$**	**17,501**	$	31,461	**$**	**32,726**
Non-broadcast		194		**(162)**		(390)		**(656)**
Corporate		(6,559)		**(5,777)**		(13,288)		**(11,883)**
Consolidated operating income from continuing operations before (gain) loss on disposal of assets	$	10,618	**$**	**11,562**	$	17,783	**$**	**20,187**

NOTE 14. SEGMENT DATA (CONTINUED)

	December 31, 2006	**June 30, 2007**
Total property, plant and equipment, net	*(Dollars in thousands)*	
Radio broadcasting	$115,604	$ **116,354**
Non-broadcast	2,830	**4,316**
Corporate	10,279	**10,138**
Consolidated property, plant and equipment, net	$128,713	$ **130,808**

	December 31, 2006	**June 30, 2007**
Goodwill	*(Dollars in thousands)*	
Radio Broadcasting	$ 5,011	$ **4,857**
Non-broadcast	15,587	**15,598**
Corporate	8	**8**
Consolidated Goodwill	$20,606	$ **20,463**

Reconciliation of operating income before depreciation, amortization, and (gain) loss on disposal of assets to income from continuing operations before income taxes:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2007**	2006	**2007**
	(Dollars in thousands)			
Operating income before depreciation, amortization, and gain (loss) on disposal of assets	$14,484	**$15,261**	$24,944	**$ 27,787**
Depreciation expense	(3,113)	**(2,923)**	(5,858)	**(6,014)**
Amortization expense	(753)	**(776)**	(1,303)	**(1,586)**
Interest income	—	**48**	46	**108**
Gain (loss) on disposal of assets	15,510	**(634)**	19,039	**2,635**
Interest expense	(6,779)	**(6,308)**	(13,367)	**(12,762)**
Other income (expense), net	(174)	**182**	(346)	**147**
Income from continuing operations before income taxes	$19,175	**$4,850**	$23,155	**$ 10,315**

NOTE 15. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The following is the consolidating information of Salem Communications Corporation for purposes of presenting the financial position and operating results of Salem Communications Holding Corporation ("Salem Holding") as the issuer of the 7¾% senior subordinated notes due 2010 (the "7 ¾ Notes") and its guarantor subsidiaries on a consolidated basis and the financial position and operating results of the other guarantors, which are consolidated within the Company. Separate financial information of Salem Holding on an unconsolidated basis is not presented because Salem Holding has substantially no assets, operations or cash other than its investments in its subsidiaries. Each guarantor has given its full and unconditional guarantee, on a joint and several basis, of indebtedness under the 7¾% Notes. Salem Holding and Salem Communications Acquisition Corporation ("AcquisitionCo") are 100% owned by Salem and Salem Holding owns 100% of all of its subsidiaries. All subsidiaries of Salem Holding are guarantors. OnePlace, LLC and CCM Communications, Inc., are aggregated and collectively referred to as "Non-broadcast." The net assets of Salem Holding are subject to certain restrictions which, among other things, require Salem Holding to maintain certain financial covenant ratios, and restrict Salem Holding and its subsidiaries from transferring funds in the form of dividends, loans or advances without the consent of the holders of the 7¾% Notes. The restricted net assets of Salem Holding as of June 30, 2007, amounted to $206.9 million. Included in intercompany receivables of Salem Holding presented in the consolidating balance sheet below is $66.8 million of amounts due from Salem and AcquisitionCo as of June 30, 2007.

NOTE 15. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (CONTINUED)

SALEM COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATING BALANCE SHEET

(Unaudited)

(Dollars in thousands)

	As of June 30, 2007					
		Guarantors		Issuer and Guarantor Subsidiaries		
	Parent	AcquisitionCo	Other Media	Salem Holding	Adjustments	Salem Consolidated
Current assets:						
Cash and cash equivalents	$ —	$ 123	$ 314	$ 315	$ —	$ 752
Trade accounts receivable, net	—	2,901	718	27,789	(73)	31,335
Other receivables	—	11	3	567	—	581
Prepaid expenses	—	134	245	2,037	—	2,416
Income tax receivable	—	(6)	(5)	50	—	39
Deferred income taxes	—	305	153	4,551	—	5,009
Total current assets	—	3,468	1,428	35,309	(73)	40,132
Investment in subsidiaries	215,654	—	—	—	(215,654)	—
Property, plant and equipment, net	—	7,726	415	122,667	—	130,808
Broadcast licenses	—	94,473	—	377,990	—	472,463
Goodwill	—	10,256	2,565	7,642	—	20,463
Other indefinite-lived intangible assets	—	—	2,892	—	—	2,892
Amortizable intangible assets, net	—	4,625	1,002	1,471	—	7,098
Bond issue costs	—	—	—	518	—	518
Bank loan fees	—	—	—	2,488	—	2,488
FV of interest rate swap	—	—	—	2,663	—	2,663
Intercompany receivables	106,818	10,477	—	184,360	(301,655)	—
Other assets	—	60	26	4,363	—	4,449
Total assets	$ 322,472	$ 131,085	$ 8,328	$ 739,471	$ (517,382)	$ 683,974

NOTE 15. CONSOLIDATING FINANCIAL STATEMENTS (CONTINUED)

SALEM COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATING BALANCE SHEET

(Unaudited)

(Dollars in thousands)

	As of June 30, 2007					
		Guarantors		Issuer and Guarantor Subsidiaries		
	Parent	AcquisitionCo	Other Media	Salem Holding	Adjustments	Salem Consolidated
Current liabilities:						
Accounts payable	$ —	$ (42)	$ 65	$ 1,473	$ —	$ 1,496
Accrued expenses	—	593	482	5,315	(126)	6,264
Accrued compensation and related expenses	—	729	125	6,558	—	7,412
Accrued interest	—	—	—	2,252	—	2,252
Deferred revenue	—	—	4,003	562	—	4,565
Current maturities of long-term debt	—	1,242	—	2,441	—	3,683
Total current liabilities	—	2,522	4,675	18,601	(126)	25,672
Intercompany payables	77,178	104,404	14,730	105,290	(301,602)	—
Long-term debt	—	1,305	—	343,646	—	344,951
Deferred income taxes	1,260	13,777	(9,819)	55,592	—	60,810
Deferred revenue	—	598	(1,576)	8,281	—	7,303
Other liabilities	—	—	—	1,204	—	1,204
Stockholders' equity	244,034	8,479	318	206,857	(215,654)	244,034
Total liabilities and stockholders' equity	$ 322,472	$ 131,085	$ 8,328	$ 739,471	$ (517,382)	$ 683,974

NOTE 15. CONSOLIDATING FINANCIAL STATEMENTS (CONTINUED)

SALEM COMMUNICATIONS CORPORATION

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

(Unaudited)

(Dollars in thousands)

	Six Months Ended June 30, 2007					
		Guarantors			Issuer and Guarantor Subsidiaries	
	Parent	AcquisitionCo	Other Media	Salem Holding	Adjustments	Salem Consolidated
Net broadcasting revenue	$ —	$ 5,729	$ —	$ 99,665	$ (1,304)	$ 104,090
Non-broadcast revenue	—	6,356	3,615	2,592	(521)	12,042
Total revenue	—	12,085	3,615	102,257	(1,825)	116,132
Operating expenses:						
Broadcasting operating expenses	—	3,920	—	62,107	85	66,112
Non-broadcast operating expenses	—	6,101	4,251	1,987	(1,416)	10,923
Corporate expenses	—	655	—	11,149	(494)	11,310
Depreciation	—	480	78	5,456	—	6,014
Amortization	—	841	229	516	—	1,586
Gain (loss) on disposal of assets	—	1	—	(2,636)	—	(2,635)
Total operating expenses	—	11,998	4,558	78,579	(1,825)	93,310
Operating income (loss)	—	87	(943)	23,678	–—	22,822
Other income (expense):						
Equity in earnings of consolidated subsidiaries, net	6,175	—	—	—	(6,175)	—
Interest income	3,881	5	—	6,614	(10,392)	108
Interest expense	(4,375)	(4,921)	(844)	(13,014)	10,392	(12,762)
Other income, net	—	—	—	147	—	147
Income (loss) before income taxes	5,681	(4,829)	(1,787)	17,425	(6,175)	10,315
Provision (benefit) for income taxes	(208)	(1,604)	(847)	7,085	—	4,426
Net income (loss)	$ 5,889	$ (3,225)	$ (940)	$ 10,340	$ (6,175)	$ 5,889
Other comprehensive income	824	—	—	824	(824)	824
Comprehensive income (loss)	$ 6,713	$ (3,225)	$ (940)	$ 11,164	$ (6,999)	$ 6,713

NOTE 16. SUBSEQUENT EVENT

On August 9, 2007, the Company announced that its Board of Directors declared a special cash dividend of $0.42 per share on its Class A and Class B common stock. The dividend payment will be paid on August 23, 2007 to shareholders of record at the close of business on August 20, 2007. The dividend payment will be approximately $10.0 million.

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

GENERAL

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this report. Our condensed consolidated financial statements are not directly comparable from period to period due to acquisitions and dispositions of selected assets of radio stations and acquisitions of non-broadcast businesses. See Note 3 of our condensed consolidated financial statements for additional information.

We believe that we are the largest commercial U.S. radio broadcasting company, measured by number of stations and audience coverage, providing programming targeted at audiences interested in Christian and family-themed radio programming. Our core business is the ownership and operation of radio stations in large metropolitan markets. Upon completion of all announced transactions, we will own a national portfolio of 97 radio stations in 38 markets, including 61 stations in 23 of the top 25 markets, which consists of 30 FM stations and 67 AM stations. We are one of only four commercial radio broadcasters with radio stations in all of the top 10 markets. We are the sixth largest operator measured by number of stations overall and the third largest operator measured by number of stations in the top 25 markets.

Our radio business is focused on the clustering of three strategic formats: Christian Teaching and Talk, Contemporary Christian Music and conservative News Talk. We also own and operate Salem Radio Network® ("SRN"), a national radio network that syndicates music, news and talk to approximately 2,000 affiliated radio stations, in addition to our owned and operated stations. Salem Radio Representatives® ("SRR") is a national radio advertising sales firm with offices in 13 U.S. cities.

We also own Salem Web Network™ ("SWN"), a provider of online Christian content and streaming, including Townhall.com, a provider of conservative content on-line, and Salem Publishing™, a leading publisher of Christian magazines and Xulon Press, a digital publisher of books targeting the Christian audience.

Our principal business strategy is to improve our national radio platform and non-broadcast businesses in order to deliver compelling content to audiences interested in Christian and family-themed programming and conservative news talk. Our national presence gives advertisers a station platform that is a unique and powerful way to reach a Christian audience. We program 45 of our stations with our Christian Teaching and Talk format, which is talk programming with Christian and family themes. A key programming strategy on our Christian Teaching and Talk radio stations is to sell blocks of time to a variety of charitable organizations that create compelling radio programs. We also program 30 News Talk and 13 Contemporary Christian Music stations. SRN supports our strategy by allowing us to reach listeners in markets where we do not own or operate stations. Additionally, we operate numerous Internet websites and publish periodicals that target similar audiences.

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 Securities and Exchange Commission ("SEC"). *Any information found on our website is not a part of, or incorporated by reference into, this or any other report of the Company filed with, or furnished to, the SEC.*

OVERVIEW

As a radio broadcasting company with a national radio network, we derive our broadcasting revenue primarily from the sale of broadcast time and radio advertising on a national and local basis.

Historically, our principal sources of revenue have been:

- the sale of block program time, both to national and local program producers,
- the sale of advertising time on our radio stations, both to national and local advertisers, and
- the sale of advertising time on our national radio network.

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

- audience share,
- how well our stations perform for our clients,
- the size of the market,
- the general economic conditions in each market, and
- supply and demand on both a local and national level.

Our sources of revenue and product offerings also increasingly include non-broadcast businesses, including our Internet and publishing businesses.

Our broadcasting revenue is affected primarily by the program rates our radio stations charge, the level of broadcast air time 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 our Christian Teaching and Talk stations. Instead, we have marketed ourselves to advertisers based upon the responsiveness of our audiences. In selected markets, for our Contemporary Christian music and conservative News Talk stations, we 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.

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.

Our cash flow is 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. The length of this period is dependent on a number of factors including the format, advertisers and ratings.

In the broadcasting industry, radio stations often utilize trade or barter agreements to exchange advertising time for goods or services (such as non-broadcast advertising, travel or lodging) 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. During 2006, we sold 96% of our advertising time for cash. It is our general policy not to preempt advertising paid for in cash with advertising paid for in trade. In addition, we generally do not pay commissions to sales people for advertising paid 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 will continue to incur significant depreciation, amortization and interest expense as a result of completed and future acquisitions of radio stations and existing and future borrowings.

Salem Web Network™ and Townhall.com, our Internet businesses, earn their revenues from the sales of streaming services, sales of advertising and, to a lesser extent, sales of software and software support contracts. Salem Publishing™, our publishing business, earns its revenue by selling advertising in and subscriptions to its publications and by selling books. Xulon Press earns its revenues from the publishing of books. The revenue and related operating expenses of these businesses are reported as "non-broadcast" on our Condensed Consolidated Statement of Operations.

SAME STATION DEFINITION

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

RESULTS OF OPERATIONS

The following table sets forth certain statements of operations data for the periods indicated and shows percentage changes:

	Three Months Ended June 30,			**Six Months Ended June 30,**		
	2006	**2007**	% Change	2006	**2007**	% Change
Net broadcasting revenue	$ 53,381	**$ 53,650**	0.5%	$ 102,155	**$ 104,090**	1.9%
Non-broadcast revenue	4,684	**6,388**	36.4%	7,936	**12,042**	51.7%
Total revenue	58,065	**60,038**	3.4%	110,091	**116,132**	5.5%
Operating expenses:						
Broadcasting operating expenses	33,498	**33,629**	0.4%	65,192	**66,112**	1.4%
Non-broadcast operating expenses	3,827	**5,652**	47.7%	7,259	**10,923**	50.5%
Corporate expenses	6,256	**5,496**	(12.1%)	12,696	**11,310**	(10.9%)
Depreciation	3,113	**2,923**	(6.1%)	5,858	**6,014**	2.7%
Amortization	753	**776**	3.1%	1,303	**1,586**	21.7%
(Gain) loss on disposal of assets	(15,510)	**634**	(104.1%)	(19,039)	**(2,635)**	(86.2%)
Total operating expenses	31,937	**49,110**	53.8%	73,269	**93,310**	27.4%
Operating income from continuing operations	26,128	**10,928**	(58.2%)	36,822	**22,822**	(38.0%)
Other income (expense):						
Interest income	—	**48**	100.0%	46	**108**	134.8%
Interest expense	(6,779)	**(6,308)**	(6.9%)	(13,367)	**(12,762)**	(4.5%)
Other income (expense), net	(174)	**182**	(204.6%)	(346)	**147**	(142.5%)
Income from continuing operations before income taxes	19,175	**4,850**	(74.7%)	23,155	**10,315**	(55.5%)
Provision for income taxes	7,584	**1,926**	(74.6%)	9,178	**4,426**	(51.8%)
Income from continuing operations	11,591	**2,924**	(74.8%)	13,977	**5,889**	(57.9%)
Income (loss) from discontinued operations, net of tax	(25)	—	(100.0%)	304	**—**	(100.0%)
Net income	$ 11,566	**$ 2,924**	(74.7%)	$ 14,281	**$ 5,889**	(58.8%)

The following table presents selected financial data for the periods indicated as a percentage of total revenue:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2007**	2006	**2007**
Net broadcasting revenue	92%	**89%**	93%	**90%**
Non-broadcast revenue	8%	**11%**	7%	**10%**
Total revenue	100%	**100%**	100%	**100%**
Operating expenses:				
Broadcasting operating expenses	58%	**56%**	59%	**57%**
Non-broadcast operating expenses	7%	**10%**	7%	**9%**
Corporate expenses	11%	**9%**	12%	**10%**
Depreciation	5%	**5%**	5%	**5%**
Amortization	1%	**1%**	1%	**1%**
(Gain) loss on disposal of assets	(27)%	**1%**	(17)%	**(2)%**
Total operating expenses	55%	**82%**	67%	**80%**
Operating income from continuing operations	45%	**18%**	33%	**20%**
Other income (expense):				
Interest income	—%	**—%**	—%	**—%**
Interest expense	(12)%	**(10)%**	(12)%	**(11)%**
Other expense, net	**—%**	**—%**	—%	**—%**
Income from continuing operations before income taxes	33%	**8%**	21%	**9%**
Provision for income taxes	13%	**3%**	8%	**4%**
Income from continuing operations	20%	**5%**	13%	**5%**
Discontinued operations, net of tax	—%	**—%**	—%	**—%**
Net income	20%	**5%**	13%	**5%**

Three months ended June 30, 2007 compared to three months ended June 30, 2006

NET BROADCASTING REVENUE. Net broadcasting revenue increased $0.3 million or 0.5% to $53.7 million for the quarter ended June 30, 2007 from $53.4 million for the same quarter of the prior year. On a same station basis, net broadcasting revenue improved $0.8 million or 1.5% to $52.9 million for the quarter ended June 30, 2007 from $52.1 million for the same quarter of the prior year. The increase is attributable to a $1.2 million increase in national programming revenue on our Christian Teaching and Talk stations and $1.0 million in revenue from a radio event held in June 2007 and in July of the prior year, partially offset by a $1.7 million decline in local advertising revenues across all of our radio stations. Revenue from advertising as a percentage of our net broadcasting revenue decreased to 49.5% for the quarter ended June 30, 2007 from 53.1% for the same quarter of the prior year. Revenue from block program time as a percentage of our net broadcasting revenue increased to 35.4% for the quarter ended June 30, 2007 from 34.0% for the same quarter of the prior year.

NON-BROADCAST REVENUE. Non-broadcast revenue increased $1.7 million or 36.4% to $6.4 million for the quarter ended June 30, 2007 from $4.7 million for the same quarter of the prior year. The increase was primarily due to revenue derived from our 2006 acquisitions of Townhall.com, Preaching Magazine and Xulon Press. For the quarter ended June 30, 2007, revenue generated from these entities was approximately $2.4 million compared to $0.7 million for the same quarter of the prior year.

BROADCASTING OPERATING EXPENSES. Broadcasting operating expenses increased $0.1 million or 0.4% to $33.6 million for the quarter ended June 30, 2007 from $33.5 million for the same quarter of the prior year. On a same station basis, broadcasting operating expenses increased $0.6 million or 2.0% to $32.7 million for the quarter ended June 30, 2007 from $32.1 million for the same quarter of the prior year. The increase is primarily attributable to higher production and programming costs of $0.2 million on our News Talk and Contemporary Christian Music radio stations and higher facility related costs of $0.1 million partially offset by lower bad debt charges of $0.2 million.

NON-BROADCAST OPERATING EXPENSES. Non-broadcast operating expenses increased $1.9 million or 47.7% to $5.7 million for the quarter ended June 30, 2007 from $3.8 million for the same quarter of the prior year. The increase is attributable primarily to costs associated with the acquisitions of Townhall.com, Preaching Magazine and Xulon Press as well as the development of our magazine Internet websites. For the quarter ended June 30, 2007, acquisitions accounted for approximately $2.0 million of expenses compared to $0.6 million for the same quarter of the prior year.

CORPORATE EXPENSES. Corporate expenses decreased $0.8 million or 12.1% to $5.5 million for the quarter ended June 30, 2007 from $6.3 million for the same quarter of the prior year. The decrease is primarily due to a reduction in stock-based compensation expense of $0.4 million and a decrease in legal fees of $0.2 million.

DEPRECIATION. Depreciation expense decreased $0.2 million or 6.1% to $2.9 million for the quarter ended June 30, 2007 from $3.1 million for the same quarter of the prior year. The decrease is due to assets becoming fully depreciated during 2007 offset by capital expenditures during the quarter.

AMORTIZATION. Amortization expense remained consistent at $0.8 million for the quarter ended June 30, 2007 and for the same quarter of the prior year.

(GAIN)LOSS ON DISPOSAL OF ASSETS. The loss on disposal of $0.6 million for the quarter ended June 30, 2007 includes the loss recognized upon the sale of selected assets of WVRY-FM, Nashville, Tennessee for $0.9 million resulting in a pre-tax loss of $0.5 million. The gain on disposal of assets of $15.5 million for same quarter of the prior year was primarily due to gains recognized on various transactions. Selected assets of KLMG-FM, Sacramento, California, were exchanged for selected assets of radio station KKFS-FM, Sacramento, California, which resulted in a pre-tax gain of $14.6 million. Additionally, we sold selected assets of WCCD-AM in Cleveland, Ohio, for $2.1 million resulting in a pre-tax gain of $1.6 million, which was partially offset by a sale of selected assets of KBAA-FM, Sacramento, California, for $0.5 million, resulting in a pre-tax loss of $0.6 million.

OTHER INCOME (EXPENSE). Interest income of $48,000 was interest earned on excess cash. Interest expense decreased $0.5 million, or 6.9%, to $6.3 million for the quarter ended June 30, 2007, compared to $6.8 million for the same quarter of the prior year. The decrease in interest expense is due to a decrease in our net outstanding debt partially offset by higher interest rates. Other income of $0.2 million for the quarter ended June 30, 2007 consisted primarily of royalty income from real estate properties offset with bank commitment fees associated with our credit facilities. Other expense of $0.2 million for the same quarter of the prior year consisted of commitment fees associated with our credit facilities.

PROVISION FOR INCOME TAXES. We adopted FIN No. 48 as of January 1, 2007. Provision for income taxes was $1.9 million for the quarter ended June 30, 2007 compared to $7.6 million for the same quarter of the prior year. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 39.7% for the quarter ended June 30, 2007 compared to 39.6% for the same quarter 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.

LOSS FROM DISCONTINUED OPERATIONS, NET OF TAX. Loss from discontinued operations was approximately $25,000 net of income taxes for the quarter ended June 30, 2006 and includes the operating results of WBTK-AM, WITH-AM, WBGB-FM, WJGR-AM, WZNZ-AM and WZAZ-AM, which were presented as discontinued operations for the quarter ended June 30, 2006 as discussed in Note 3.

NET INCOME. We recognized net income of $2.9 million for the quarter ended June 30, 2007 as compared to $11.6 million for the same quarter of the prior year. The decrease of $8.7 million resulted from the impact of the gain on the disposal of assets of $15.5 million recognized during the quarter ended June 30, 2006, partially offset by a decrease in the tax provision of $5.7 million and a decrease in corporate expense of $0.8 million.

Six months ended June 30, 2007 compared to six months ended June 30, 2006

NET BROADCASTING REVENUE. Net broadcasting revenue increased $1.9 million or 1.9% to $104.1 million for the six months ended June 30, 2007 from $102.2 million for the same period of the prior year. On a same station basis, net broadcasting revenue improved $2.5 million or 2.5% to $102.3 million for the six months ended June 30, 2007 from $99.8 million for the same period of the prior year. The growth is primarily attributable to increases in national program revenue on our Christian Teaching and Talk stations of $2.6 million and in local spot sales on our Contemporary Christian Music station of $1.1 million partially offset by a $2.2 million decline in advertising revenues on all of our radio stations. Revenue from advertising as a percentage of our net broadcasting revenue decreased to 49.2% for the six months ended June 30, 2007 from 52.3% for the same period of the prior year. Revenue from block program time as a percentage of our net broadcasting revenue increased to 36.4% for the six months ended June 30, 2007 from 34.7% for the same period of the prior year. This change in our revenue mix was primarily due to growth of block programming revenue on our Christian Teaching and Talk stations impacted by an overall trend in the radio broadcasting industry of negative growth of advertising revenue. We anticipate that this trend in the radio broadcasting industry may continue, however we cannot quantify the financial impact on our future operating results.

NON-BROADCAST REVENUE. Non-broadcast revenue increased $4.1 million or 51.7% to $12.0 million for the six months ended June 30, 2007 from $7.9 million for the same period of the prior year. The increase was primarily due to revenue derived from our 2006 acquisitions Townhall.com, Preaching Magazine and Xulon Press plus organic growth of advertising revenue at Salem Web Network™. For the six months ended June 30, 2007, acquisitions accounted for approximately $4.2 million of revenue compared to $0.7 million the same period of the prior year.

BROADCASTING OPERATING EXPENSES. Broadcasting operating expenses increased $0.9 million or 1.4% to $66.1 million for the six months ended June 30, 2007 from $65.2 million for the same period of the prior year. On a same station basis, broadcasting operating expenses increased $1.8 million or 2.9% to $64.2 million for the six months ended June 30, 2007 from $62.4 million for the same period of the prior year. The increase is primarily due to higher advertising and promotion costs of $0.7 million and higher facility related costs of $0.