

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

<u>Class A</u>	<u>Outstanding at November 5, 2008</u>
Common Stock, \$0.01 par value per share	18,120,092 shares
<u>Class B</u>	<u>Outstanding at November 5, 2008</u>
Common Stock, \$0.01 par value per share	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,” “estimates,” “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”).

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**PART I - FINANCIAL INFORMATION**  
**SALEM COMMUNICATIONS CORPORATION**

**ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)**

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

ASSETS	December 31, 2007 (Note 1)	September 30, 2008 (Unaudited)
<b>Current assets:</b>		
Cash and cash equivalents	\$ 447	\$ 184
Trade accounts receivable (less allowance for doubtful accounts of \$8,131 in 2007 and \$7,917 in 2008)	30,030	29,743
Other receivables	635	343
Prepaid expenses	2,621	2,808
Deferred income taxes	5,567	5,181
Assets of discontinued operations	8,829	204
<b>Total current assets</b>	<b>48,129</b>	<b>38,463</b>
Property, plant and equipment (net of accumulated depreciation of \$81,407 in 2007 and \$90,627 in 2008)	130,857	136,564
Broadcast licenses	464,549	452,109
Goodwill	18,636	18,717
Other indefinite-lived intangible assets	2,892	2,892
Amortizable intangible assets (net of accumulated amortization of \$13,882 in 2007 and \$15,956 in 2008)	6,079	5,198
Bond issue costs	444	333
Bank loan fees	1,994	1,235
Notes receivable	1,168	2,948
Other assets	5,050	7,109
<b>Total assets</b>	<b>\$ 679,798</b>	<b>\$ 665,568</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 1,325	\$ 970
Accrued expenses	6,134	6,166
Accrued compensation and related expenses	7,297	7,234
Accrued interest	553	4,344
Deferred revenue	4,205	6,164
Income tax payable	109	34
Current portion of long-term debt and capital lease obligations	6,667	3,751
<b>Total current liabilities</b>	<b>26,290</b>	<b>28,663</b>
Long-term debt and capital lease obligations, less current portion	347,617	332,193
Fair value of interest rate swap agreements	2,489	3,290
Deferred income taxes	61,381	58,745
Deferred revenue	7,500	7,761
Other liabilities	1,343	1,384
<b>Total liabilities</b>	<b>446,620</b>	<b>432,036</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity:</b>		
Class A common stock, \$0.01 par value; authorized 80,000,000 shares; 20,432,742 issued and 18,115,092 and 18,120,092 outstanding at December 31, 2007 and at September 30, 2008, respectively	204	204
Class B common stock, \$0.01 par value; authorized 20,000,000 shares; 5,553,696 issued and outstanding shares at December 31, 2007 and at September 30, 2008	56	56
Additional paid-in capital	224,878	228,207
Retained earnings	43,538	41,043
Treasury stock, at cost (2,317,650 shares at December 31, 2007 and September 30, 2008)	(34,006)	(34,006)
Accumulated other comprehensive loss	(1,492)	(1,972)
<b>Total stockholders' equity</b>	<b>233,178</b>	<b>233,532</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 679,798</b>	<b>\$ 665,568</b>

See accompanying notes

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2008	2007	2008
Net broadcast revenue	\$ 50,864	\$ 47,371	\$ 153,001	\$ 145,226
Non-broadcast revenue	6,018	7,057	17,480	20,711
Total revenue	56,882	54,428	170,481	165,937
<b>Operating expenses:</b>				
Broadcast operating expenses, exclusive of depreciation and amortization shown below (including \$311 and \$312 for the quarter ended September 30, 2007 and 2008, respectively, and \$927 and \$945 for the nine months ended September 30, 2007 and 2008, respectively, paid to related parties)	31,925	30,942	96,423	94,634
Non-broadcast operating expenses, exclusive of depreciation and amortization shown below	5,594	6,477	15,903	19,564
Corporate expenses, exclusive of depreciation and amortization shown below (including \$192 and \$20 for the quarter ended September 30, 2007 and 2008, respectively, and \$337 and \$152 for the nine months ended September 30, 2007 and 2008, respectively, paid to related parties)	5,425	6,555	16,735	16,314
Depreciation (including \$181 and \$455 for the quarter ended September 30, 2007 and 2008, respectively, and \$470 and \$1,100 for the nine months ended September 30, 2007 and 2008, respectively for non-broadcast businesses)	2,926	3,506	8,845	9,983
Amortization (including \$721 and \$705 for the quarter ended September 30, 2007 and 2008, respectively, and \$2,207 and \$2,003 for the nine months ended September 30, 2007 and 2008, respectively for non-broadcast businesses)	748	712	2,334	2,053
Impairment of long-lived assets	—	20,320	—	20,320
(Gain) loss on disposal of assets	309	142	(2,329)	(5,862)
Total operating expenses	46,927	68,654	137,911	157,006
Operating income (loss) from continuing operations	9,955	(14,226)	32,570	8,931
<b>Other income (expense):</b>				
Interest income	52	47	160	181
Interest expense	(6,375)	(5,453)	(19,137)	(17,015)
Other income, net	83	278	230	178
Income (loss) from continuing operations before income taxes	3,715	(19,354)	13,823	(7,725)
Provision for (benefit from) income taxes	1,698	(8,235)	6,035	(3,100)
Income (loss) from continuing operations	2,017	(11,119)	7,788	(4,625)
Income from discontinued operations, net of tax	81	77	199	2,130
Net income (loss)	\$ 2,098	\$ (11,042)	\$ 7,987	\$ (2,495)
Other comprehensive loss, net of tax	(1,498)	(297)	(674)	(480)
Comprehensive income (loss)	\$ 600	\$ (11,339)	\$ 7,313	\$ (2,975)
Basic earnings per share from continuing operations	\$ 0.08	\$ (0.47)	\$ 0.33	\$ (0.20)
Income per share from discontinued operations	—	—	0.01	0.09
Basic earnings per share	\$ 0.09	\$ (0.47)	\$ 0.34	\$ (0.11)
Diluted earnings per share from continuing operations	\$ 0.08	\$ (0.47)	\$ 0.33	\$ (0.20)
Income per share from discontinued operations	—	—	0.01	0.09
Diluted earnings per share	\$ 0.09	\$ (0.47)	\$ 0.34	\$ (0.11)
Basic weighted average shares outstanding	23,772,647	23,673,788	23,823,757	23,670,455
Diluted weighted average shares outstanding	23,776,449	23,673,788	23,828,495	23,670,455

See accompanying notes

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

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2008</b>
<b>OPERATING ACTIVITIES</b>		
Income (loss) from continuing operations	\$ 7,788	\$ (4,625)
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Non-cash stock-based compensation	2,515	3,330
Depreciation and amortization	11,179	12,036
Amortization of bond issue costs and bank loan fees	871	870
Amortization and accretion of financing items	82	41
Provision for bad debts	1,875	3,464
Deferred income taxes	5,960	(1,929)
Impairment of long-lived assets	—	20,320
Gain on disposal of assets	(2,329)	(5,862)
Changes in operating assets and liabilities:		
Accounts receivable	(1,117)	(2,733)
Prepaid expenses and other current assets	(254)	(187)
Accounts payable and accrued expenses	(1,829)	4,052
Deferred revenue	977	2,220
Other liabilities	127	41
Income taxes payable	(22)	(75)
Net cash provided by continuing operating activities	<u>25,823</u>	<u>30,963</u>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(11,853)	(7,944)
Deposit on radio station acquisitions	—	(2,725)
Purchase of broadcast assets	—	(12,315)
Purchase of non-broadcast businesses	(962)	(1,337)
Purchase of real estate from principal stockholders	—	(5,013)
Proceeds from the disposal of assets	7,963	6,253
Other	(747)	91
Net cash used in investing activities of continuing operations	<u>(5,599)</u>	<u>(22,990)</u>
<b>FINANCING ACTIVITIES</b>		
Proceeds from borrowings under credit facilities	20,500	15,000
Payments of long-term debt and notes payable	(29,624)	(29,210)
Net borrowings and repayment on Swingline credit facility	1,145	(2,952)
Repurchase of Class A common stock	(1,788)	—
Payment of dividend on common stock	(10,010)	—
Proceeds from exercise of stock options	30	—
Tax benefit related to stock options exercised	1	(1)
Payments on capital lease obligations	(24)	(1,363)
Book overdraft	(729)	(465)
Net cash used in financing activities	<u>(20,499)</u>	<u>(18,991)</u>
<b>CASH FLOWS OF DISCONTINUED OPERATIONS</b>		
Operating cash flows	344	(1,095)
Investing cash flows	(106)	11,850
Total cash inflows from discontinued operations	<u>238</u>	<u>10,755</u>
Net decrease in cash and cash equivalents	(37)	(263)
Cash and cash equivalents at beginning of year	710	447
Cash and cash equivalents at end of period	<u>\$ 673</u>	<u>\$ 184</u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the period for		
Interest	\$ 18,691	\$ 14,434
Income taxes	\$ 293	\$ 418
<b>Non-cash investing and financing activities:</b>		
Assets acquired through capital lease obligations	\$ 800	\$ —
Notes receivable acquired in exchange for radio station	\$ —	\$ 1,500

See accompanying notes

**SALEM COMMUNICATIONS CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 1. BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements of Salem Communications Corporation (“Salem” 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 nine months ended September 30, 2008 and 2007 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 the Company’s annual report on Form 10-K for the year ended December 31, 2007.

The balance sheet at December 31, 2007 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 items shown in the 2007 consolidated financial statements have been reclassified to conform to the current period presentation. These reclassifications include the accounting for WRRD-AM, Milwaukee, Wisconsin, WFZH-FM, Milwaukee, Wisconsin, WRFD-AM, Columbus, Ohio and *CCM Magazine*, as discontinued operations as discussed in Note 4. The accompanying Condensed Consolidated Balance Sheets and Statements of Operations reflect the operating results and net assets of these entities as discontinued operations for the three and nine months ended September 30, 2008 and 2007.

**NOTE 3. IMPAIRMENT OF LONG-LIVED ASSETS**

The Company accounts for goodwill and other indefinite lived intangible assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets.” Accordingly, the Company does not amortize goodwill or other indefinite lived intangible assets, but rather tests for impairment at least annually, or more frequently if events or circumstances indicate that an asset may be impaired. Broadcast licenses account for approximately 95% of the Company’s indefinite-lived intangible assets. Goodwill and magazine mastheads account for the remaining 5%. The unit of accounting used to test broadcast licenses is the cluster level, which the Company defines as a group of radio stations operating in the same geographic market, sharing the same building and equipment and being managed by a single general manager. Goodwill and mastheads, attributable primarily to the non-broadcast operating segment, are tested at the business unit level, which the Company defines by publication or website.

The Company completes its annual impairment tests in the fourth quarter of each year. However, based on deteriorating macro-economic factors, including declining radio industry revenues throughout 2008 to date and a weakening in prevailing radio station transaction multiples, the Company concluded that, in connection with preparing its financial statements for the period ended September 30, 2008, an interim valuation pursuant to SFAS No. 142 was appropriate. The Company reviewed the financial performance of certain accounting units against established internal benchmarks. For selected accounting units that did not meet the internal benchmarks, Bond & Pecaro, an independent third party appraisal and valuation firm, was engaged to perform an appraisal of the indefinite-lived asset(s). The accounting units selected were based on declines in projected market revenues and market analysis from industry experts that indicate a more than remote likelihood that a current fair value determination would be less than the carrying value. As a result of the Company’s interim review and valuation, a pre-tax impairment charge of \$20.3 million associated with the value of broadcast licenses in the Cleveland market was recognized in the third quarter of 2008.

The valuation of intangible assets is subjective and based on estimates rather than precise calculations. If actual future results are not consistent with the assumptions and estimates used, the Company may be exposed to impairment charges in the future.



**NOTE 4. SIGNIFICANT TRANSACTIONS**

On March 28, 2008, the Company sold radio station KTEK-AM in Houston, Texas for \$7.8 million, including \$4.5 million in cash, and \$3.3 million in notes receivables. The notes include a \$1.8 million 90 day promissory note due on June 24, 2008 bearing interest at 8% per annum and a \$1.5 million seven year promissory note bearing interest at 8% per annum, with monthly installments due beginning in May 2008. The sale resulted in a pre-tax gain of \$6.1 million. The operating results of KTEK-AM were excluded from the Condensed Consolidated Statement of Operations beginning on February 1, 2008, the date the Company stopped operating the station pursuant to a Time Brokerage Agreement with the buyer.

On March 28, 2008, the Company sold radio station WRRD-AM in Milwaukee, Wisconsin for \$3.8 million resulting in a pre-tax gain of \$2.2 million which is reported as a component of discontinued operations. The accompanying Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2008 reflect WRRD-AM as a discontinued operation. All prior periods have been revised to reflect the operating results of the station as a discontinued operation to conform to the current period presentation.

On May 30, 2008, the Company sold radio station WFZH-FM in Milwaukee, Wisconsin for \$8.1 million resulting in a pre-tax gain of \$1.4 million which is reported as a component of discontinued operations. The accompanying Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2008 reflect WFZH-FM as a discontinued operation. All prior periods have been revised to reflect the operating results of the station as a discontinued operation to conform to the current period presentation.

On April 8, 2008, the Company acquired land in Seattle, Washington, Denver, Colorado and Pittsburgh, Pennsylvania from entities controlled by its Chairman and by its CEO ("Principal Shareholders") for \$5.0 million. As a result of this transaction, the Company will reduce rental expense by approximately \$148,000 annually and has permanently secured these AM transmitter site locations. The Company also assumed two income-producing lease agreements as follows: (a) a duplex agreement at the Seattle-Tacoma, Washington site generating current annual rental income of approximately \$139,000, and (b) a mobile telephone lease at the Pittsburgh, Pennsylvania site generating current annual rental income of approximately \$26,000. A prerequisite negotiated by the Company as an important condition of the closing of the Transmitter Site Purchases was the entry by the Company into new transmitter site leases for eight (8) existing transmitter sites (the "New Transmitter Site Leases") operated by the Company and leased from the Principal Stockholders. Seven (7) of these New Transmitter Site Leases replace existing transmitter site leases between the Company and the Principal Shareholder which were either scheduled to expire or had option exercise deadlines in 2009 or 2010. As a result, the Company is not required to renegotiate a new lease or exercise an option on any of its related party leases until 2016.

On April 11, 2008 the Company completed the purchase of selected assets of WMCU-AM in Miami, Florida, for \$12.3 million. The Company began operating the station under a local marketing agreement ("LMA") effective on October 18, 2007. The accompanying Condensed Consolidated Statements of Operations includes the operating results of this station as of the LMA date.

On June 30, 2008, the Company completed a reorganization of certain legal entities. Under this reorganization, all operating assets of the Company other than CCM Communications, Inc. are now owned by Salem Communications Holding Corporation ("Salem Holding"). The operating assets of CCM Communications, Inc. remain owned by Salem Holding. The reorganization did not impact the Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Operations, however the consolidating financial statements presented in Note 16 reflect the revised structure.

In September 2008, an agreement dated February 22, 2008 to sell radio station KKMO-AM in Seattle, Washington for approximately \$3.7 million was terminated. The buyer of the station did not meet the terms of the Asset Purchase Agreement.

During the nine months ended September 30, 2008, the Company completed the following acquisitions, none of which were material to the Company's financial position as of the date of acquisition:

Acquisition Date	Description	Total Cost
<i>(Dollars in thousands)</i>		
April 8, 2008	Land purchase from principal stockholders (asset purchase)	\$ 5,013
April 11, 2008	Acquisition of selected assets of WMCU-AM, Miami, Florida	12,315
June 6, 2008	Intercristo.com, a faith-based online job posting site (business acquisition)	1,185
August 15, 2008	Conservativevoice.com, customer list (business acquisition)	152
		<u>\$ 18,665</u>

The purchase price was allocated to the total assets acquired as follows:

	Amount	
	<i>(Dollars in thousands)</i>	
<b>Asset</b>		
Property and equipment	\$	973
Real estate		7,061
FCC License		9,417
Non-compete agreements		33
Domain and brand names		591
Customer lists and other contracts		499
Goodwill		91
	\$	18,665

**Other Pending Transactions:**

On February 1, 2007, the Company entered into an agreement to purchase selected assets of radio station KTRO-AM, in Portland, Oregon subject to certain conditions, for \$4.5 million. The Company began operating the station under an LMA effective the same date. The accompanying Condensed Consolidated Statement of Operations includes the operating results of this radio station as of the LMA date. On October 29, 2008, the Company notified the owner in accordance with the agreement that it would discontinue operating the station under the LMA and would not acquire the station.

On July 12, 2008, the Company entered an agreement to purchase radio station WZAB-AM in Miami, Florida for \$1.4 million. The Company began operating the station under an LMA agreement effective October 1, 2008. The purchase is subject to the approval of the Federal Communications Commission "FCC." and is expected to close in the first half of 2009.

On July 18, 2008, the Company paid a refundable deposit of \$2.7 million for the full purchase price of selected assets of WAMD-AM in Baltimore, Maryland. The station is not currently being operated. The transaction has been approved by the FCC and is expected to close in the first quarter of 2009.

On July 31, 2008, the Company entered into an agreement to sell radio station WRFD-AM in Columbus, Ohio for \$4.0 million. The sale is subject to the approval of the FCC and is expected to close in the fourth quarter of 2008

On August 13, 2008, the Company entered into an agreement to sell radio station WRVI-FM in Louisville, Kentucky for \$3.0 million. The sale is subject to the approval of the FCC and is expected to close in the fourth quarter of 2008.

**Discontinued Operations:**

During 2007, the Company had a plan in place to sell its radio stations in the Milwaukee market. As noted above, the Company sold radio station WRRD-AM in Milwaukee, Wisconsin for \$3.8 million on March 28, 2008 and sold radio station WFZH-FM in Milwaukee, Wisconsin for \$8.1 million on May 30, 2008. The Company entered into an LMA with the buyer effective as of February 15, 2008, under which the buyer began programming the station and paying a majority of operational costs of the station. The accompanying Condensed Consolidated Balance Sheets and Statements of Operations reflect the operating results and net assets of the entity as a discontinued operation for the three and nine months ended September 30, 2008. All prior periods have been revised to reflect the operating results and net assets of the station as a discontinued operation to conform to the current period presentation.

The Company ceased publishing the *CCM Magazine* as of March 2008. The operating results for *CCM Magazine* have been reported as a discontinued operation as of the date operations ceased. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity as a discontinued operation for the three and nine months ended September 30, 2008. All prior periods have been revised to reflect the operating results of this entity as a discontinued operation to conform to the current period presentation.

On July 31, 2008, the Company entered into an agreement to sell radio station WRFD-AM in Columbus, Ohio for \$4.0 million. As a result of the sale, the Company will exit the Columbus, Ohio market. The accompanying Condensed Consolidated Balance Sheets and Statements of Operations reflect the operating results and net assets of the entity as a discontinued operation for the three and nine months ended September 30, 2008. All prior periods have been revised to reflect the operating results and net assets of the

station as a discontinued operation to conform to the current period presentation. The sale is subject to the approval of the FCC and is expected to close in the fourth quarter of 2008.

The following table sets forth the components of income from discontinued operations, net of tax, for the three and nine months ended September 30, 2007 and 2008 (dollars in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
	<i>(Dollars in thousands)</i>			
Net revenue	\$ 1,214	\$ 470	\$ 3,748	\$ 2,145
Operating expenses	1,066	464	3,390	1,926
Operating income	\$ 148	\$ 6	\$ 358	\$ 219
Gain (loss) on sale of radio station assets	-	102	(3)	3,360
Income from discontinued operations	\$ 148	\$ 108	\$ 355	\$ 3,579
Provision for income taxes	67	31	156	1,449
Income from discontinued operations, net of tax	\$ 81	\$ 77	\$ 199	\$ 2,130

#### NOTE 5. 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 and shares of restricted stock 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 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).

During the three months ended September 30, 2008, all senior executives voluntarily surrendered options (vested and unvested) to the Company. The voluntary surrender was not accompanied by a concurrent grant of (or offer to grant) a replacement award or other valuable consideration. In accordance with SFAS No. 123(R) paragraph 57, the surrender was accounted for as a repurchase for no consideration. As a result 1,741,854 options were voluntarily surrendered resulting in approximately a \$1.6 million increase in stock based compensation expense for the three months ended September 30, 2008. The following table reflects the components of stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
	<i>(Dollars in thousands)</i>			
Stock option compensation expense included in corporate expenses	\$ 643	\$ 1,818	\$ 1,741	\$ 2,763
Restricted stock units compensation expense included in corporate expenses	15	10	47	36
Stock option compensation expense included in broadcast operating expenses	180	130	617	393
Stock option compensation expense included in non-broadcast operating expenses	43	57	110	138
Total stock-based compensation expense, pre-tax	\$ 881	\$ 2,015	\$ 2,515	\$ 3,330
Tax benefit from stock-based compensation expense	(385)	(809)	(1,108)	(1,407)
Total stock-based compensation expense, net of tax	\$ 496	\$ 1,206	\$ 1,407	\$ 1,923

#### *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. Eligible individuals 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 received restricted stock grants that vest one year from the date of issuance as well as stock options that vest immediately. The Company does not allow key employees (restricted persons) from exercising an option during a pre-defined black out period. Certain employees may have a 10b5-1 Plan available to exercise according to predefined criteria.

The Company uses the Black-Scholes option valuation model to estimate the grant date fair value of stock options. The expected volatility reflects the consideration of 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 expected term of the option. 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 term of the option are based on the U.S. Treasury yield curve in effect during the period the options were granted. Upon adoption of SFAS 123(R), the Company began using historical data to estimate forfeiture rates applied to the gross amount of expense determined using the option valuation model. Prior to adoption of SFAS 123(R), the Company recognized forfeitures as they occurred. There was no material impact upon adoption of SFAS 123(R) between these methods of accounting for forfeitures. The weighted-average assumptions used to estimate the fair value of stock options granted using the Black-Scholes option valuation model were as follows for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Expected volatility	46.44%	—	44.76%	44.47% - 45.08%
Expected dividends	0.0%	—	0.0%	3.68% - 4.91%
Expected term (in years)	6 - 9	—	6 - 9	6 - 12
Risk-free interest rate	4.16%	—	4.48%	2.76% - 3.86%

Stock option information with respect to the Company's stock-based compensation plan for the nine months ended September 30, 2008 and 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		\$ 14.11	\$ —
Granted	393,900	11.79		8.21	—
Exercised	(2,500)	11.81		9.43	4
Forfeited or expired	(106,790)	19.59		13.73	—
Outstanding at September 30, 2007	2,431,174	20.73	4.5 years	13.18	—
Exercisable at September 30, 2007	1,436,762	24.32	2.8 years	15.09	—
Outstanding at January 1, 2008	2,422,024	\$ 20.74		13.17	\$ —
Granted	55,000	5.48		1.86	—
Exercised	—	—		—	—
Forfeited or expired	(1,866,474)	22.38		14.19	—
Outstanding at September 30, 2008	610,550	14.37	4.6 years	9.04	—
Exercisable at September 30, 2008	327,897	16.57	2.9 years	10.26	—

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 the Company's restricted stock grants for the nine months ended September 30, 2008 and 2007 is as follows:

Restricted Stock Units	Shares	Weighted Average Grant Date Fair Value
Non-Vested at January 1, 2007	6,000	\$ 11.15
Granted	5,000	10.15
Vested	(6,000)	11.15
Forfeited	—	—
Non-Vested at September 30, 2007	5,000	10.15
Non-Vested at January 1, 2008	5,000	10.15
Granted	—	—
Vested	(5,000)	10.15
Forfeited	—	—
Non-Vested at September 30, 2008	—	—

As of September 30, 2008, there was \$0.9 million of total unrecognized compensation expense related to non-vested awards of stock options and restricted shares. This cost is to be recognized over a weighted average period of 1.4 years.

#### NOTE 6. OTHER COMPREHENSIVE LOSS

Other comprehensive loss reflects changes in the fair value of each of the Company's cash flow hedges for the three and nine months ended September 30, 2008 and 2007 as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2008	2007	2008
	<i>(Dollars in thousands)</i>			
Mark-to-market gain (loss)	\$ (2,496)	\$ (495)	\$ (1,123)	\$ (800)
Less tax provision (benefit)	998	198	449	320
Other comprehensive loss	\$ (1,498)	\$ (297)	\$ (674)	\$ (480)

#### NOTE 7. RECENT ACCOUNTING PRONOUNCEMENTS

##### *Statement of Financial Accounting Standards No. 162*

In May 2008, Financial Accounting Standards Board ("FASB") issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." The pronouncement mandates that the Generally Accepted Accounting Principles ("GAAP") hierarchy reside in the accounting literature as opposed to in the audit literature. This has the practical impact of elevating FASB Statements of Financial Accounting Concepts in the GAAP hierarchy. This pronouncement will become effective 60 days following SEC approval. The adoption of SFAS No. 162 will not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

##### *Statement of Financial Accounting Standards No. 161*

In March 2008, the FASB issued SFAS No. 161, "Disclosure about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133." SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The adoption of SFAS No. 161 will not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

**Statement of Financial Accounting Standards No. 160**

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51” SFAS No.160 will change the accounting and reporting for minority interests which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. The adoption of SFAS No. 160 will not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

**Statement of Financial Accounting Standards No. 159**

In February 2007, the 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 was effective beginning January 1, 2008. The Company adopted SFAS No. 159 on January 1, 2008 and has elected not to measure qualified financial assets or financial liabilities at fair value. The adoption of SFAS No. 159 did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

**Statement of Financial Accounting Standards No. 157**

On September 15, 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” which is effective for fiscal years beginning after November 15, 2007. 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. In February 2008, the FASB deferred the adoption of SFAS No. 157 for one year as it applies to certain items, including assets and liabilities initially measured at fair value in a business combination, reporting units and certain assets and liabilities measured at fair value in connection with goodwill impairment tests in accordance with SFAS No. 142 and long-lived assets measured at fair value for impairment assessments under SFAS No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*. The Company was required to adopt the provisions of SFAS No. 157 in 2008 as it relates to certain other items, including those within the scope of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, and financial and nonfinancial derivatives within the scope of SFAS No. 133. The adoption of SFAS No. 157 did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

SFAS No. 157 defines fair values as the price that would be received to acquire an asset or paid to transfer a liability in an orderly transaction between market participants, as of the measurement date. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants, as of the measurement date. The standard establishes a hierarchy of inputs employed to determine fair value measurements, with three levels. Level 1 inputs are quoted prices in active markets for identical assets and liabilities, are considered to be the most reliable evidence of fair value, and should be used whenever available. Level 2 inputs are observable prices that are not quoted on active exchanges. Level 3 inputs are unobservable inputs employed for measuring the fair value of assets or liabilities.

The Company’s financial liabilities reported at fair value in the accompanying condensed consolidated balance sheet, as of September 30, 2008, were as follows:

	As of September 30, 2008			
	<i>(Dollars in thousands)</i>			
	Level 1	Level 2	Level 3	Total
Interest rate swap agreements	—	3,290	—	3,290

**Statement of Financial Accounting Standards No. 141(R)**

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“SFAS No. 141 (R)”). SFAS No. 141(R) changes accounting for acquisitions that close beginning in 2009. More transactions and events will qualify as business combinations and will be accounted for at fair value under the new standard. SFAS No. 141(R) promotes greater use of fair values in financial reporting. Some of the changes will introduce more volatility into earnings. SFAS No. 141 (R) is effective for fiscal years beginning on or after December 15, 2008. The Company is currently assessing the impact that SFAS No. 141 (R) may have on the consolidated financial position, results of operations and cash flows.

**NOTE 8. 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 terminated December 31, 2007.

As discussed in Note 5, the Company accounts for stock-based compensation expense in accordance with SFAS No. 123(R). As a result, \$2.0 million and \$3.3 million of stock-based compensation expense has been recorded to additional paid-in capital for the three and nine months ended September 30, 2008, respectively, in comparison to \$0.9 million and \$2.5 million for the three and nine months ended September 30, 2007, respectively.

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

On October 24, 2007, the Company amended its credit facilities to ease certain financial covenants. The amendment became effective upon the closing of the acquisition of WMCU-AM, Miami, Florida on April 11, 2008. Specifically, the total leverage ratio covenant increased to 6.75 to 1 through March 30, 2009. Additionally, the senior leverage ratio covenant increased to 5.0 to 1 and the interest coverage ratio remained at 2.0 to 1 through March 30, 2009.

Long-term debt consisted of the following:

	December 31, 2007	September 30, 2008
	<i>(Dollars in thousands)</i>	
Term loans under credit facility	\$ 234,900	\$ 233,667
Revolving line of credit under credit facility	13,000	—
Swingline credit facility	2,952	—
7¼% Senior Subordinated Notes due 2010	100,000	100,000
Seller financed note to acquire Townhall.com	2,546	1,288
Capital leases and other loans	886	989
	354,284	335,944
Less current portion	6,667	3,751
	<u>\$ 347,617</u>	<u>\$ 332,193</u>

**Maturities of Long-Term Debt**

Principal repayment requirements under all long-term debt agreements outstanding at September 30, 2008 for each of the next five years and thereafter are as follows:

Twelve Months Ended September 30,	Amount
	<i>(Dollars in thousands)</i>
2009	\$ 3,751
2010	231,334
2011	100,069
2012	74
2013	57
Thereafter	659
	<u>\$ 335,944</u>

**NOTE 10. AMORTIZABLE INTANGIBLE ASSETS**

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

<b>As of September 30, 2008</b>			
Cost	Accumulated Amortization		Net
<i>(Dollars in thousands)</i>			
Customer lists and contracts	\$ 10,938	\$ (8,875)	\$ 2,063
Domain and brand names	5,567	(3,079)	2,488
Favorable and assigned leases	1,581	(1,278)	303
Other amortizable intangible assets	3,068	(2,724)	344
	<u>\$ 21,154</u>	<u>\$ (15,956)</u>	<u>\$ 5,198</u>

<b>As of December 31, 2007</b>			
Cost	Accumulated Amortization		Net
<i>(Dollars in thousands)</i>			
Customer lists and contracts	\$ 10,437	\$ (7,687)	\$ 2,750
Domain and brand names	4,910	(2,458)	2,452
Favorable and assigned leases	1,581	(1,227)	354
Other amortizable intangible assets	3,033	(2,510)	523
	<u>\$ 19,961</u>	<u>\$ (13,882)</u>	<u>\$ 6,079</u>

Based on the amortizable intangible assets as of September 30, 2008, the Company estimates amortization expense for the next five years to be as follows:

<u>Year Ending</u>	<u>Amortization Expense</u>
<i>(Dollars in thousands)</i>	
2008 (October 1 – December 31)	\$ 750
2009	1,698
2010	1,202
2011	608
2012	243
Thereafter	697
Total	<u>\$ 5,198</u>

**NOTE 11. BASIC AND DILUTED EARNINGS PER SHARE**

Basic earnings per share is 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 2,431,174 and 610,550 shares of Class A common stock were outstanding at September 30, 2007 and 2008, respectively. Unvested restricted stock shares of 5,000 were outstanding at September 30, 2007. 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 computation of diluted net income per share because their effect would be anti-dilutive. The number of dilutive shares was 3,802 and 4,738 for the three and nine month period ended September 30, 2007, respectively. Due to the net loss recognized for the nine months ended September 30, 2008, there are no potentially dilutive shares included in the calculation.



## NOTE 12. DERIVATIVE INSTRUMENTS

The Company 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 the Company's 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.

On April 8, 2005, the Company entered into an interest rate swap arrangement for the notional principal amount of \$30.0 million whereby the Company will pay a fixed interest rate of 4.99% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the three and nine months ended September 30, 2008, was increased by approximately \$0.2 million and \$0.4 million, as a result of the difference between the interest rates. As of September 30, 2008, the Company recorded a liability for the fair value of the interest swap of approximately \$1.4 million. This amount, net of income taxes of approximately \$0.6 million, is reflected in other comprehensive loss, 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 the Company will pay a fixed interest rate of 4.70% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the three and nine months ended September 30, 2008, was increased by approximately \$0.1 million and \$0.3 million, as a result of the difference between the interest rates. As of September 30, 2008, the Company recorded a liability for the fair value of the interest swap of approximately \$1.0 million. This amount, net of income taxes of approximately \$0.4 million, is reflected in other comprehensive loss, 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 the Company will pay a fixed interest rate of 4.53% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the three and nine months ended September 30, 2008, was increased by approximately \$0.1 million and \$0.3 million, as a result of the difference between the interest rates. As of September 30, 2008, the Company recorded a liability for the fair value of the interest swap of approximately \$0.9 million. This amount, net of income taxes of approximately \$0.3 million, is reflected in other comprehensive loss, 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 \$12,000 and \$9,000 was recognized during the three and nine months ended September 30, 2008, respectively, in comparison to \$200 and \$15,000 for the three and nine months ended September 30, 2007, respectively, related to the interest rate caps.

## NOTE 13. INCOME TAXES

The Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48") on January 1, 2007 and accrued liabilities for unrecognized tax benefits in accordance with the provisions. On the date of adoption the Company

had \$3.0 million in liabilities related to uncertain tax positions, including \$0.9 million recognized under SFAS No. 5 "Accounting for Contingencies" and carried forward from prior years and \$2.1 million recognized upon adoption of FIN 48 as a reduction to retained earnings. Included in the \$2.1 million accrual was \$0.1 million related interest, net of federal income tax benefits. During 2007, the Company recognized a net increase of \$0.9 million in liabilities and at December 31, 2007, had \$3.9 million in liabilities for unrecognized tax benefits. Included in this liability amount were \$0.1 million accrued for the related interest, net of federal income tax benefits, and \$0.1 million for the related penalty recorded in income tax expense on the Consolidated Statements of Operations. The Company recorded an increase in its unrecognized tax benefits of \$0.1 million as of September 30, 2008.

#### NOTE 14. COMMITMENTS AND CONTINGENCIES

The Company and its subsidiaries, incident to its business activities, are parties to a number of legal proceedings, lawsuits, arbitrations 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 15. 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 broadcast. The remaining non-reportable segments consist of Salem Web Network <sup>TM</sup> and Salem Publishing, which do not meet the reportable segment quantitative thresholds and accordingly are aggregated in the following tables as non-broadcast. The radio broadcast segment also operates various radio networks.

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

	<u>Radio Broadcast</u>	<u>Non-broadcast</u>	<u>Corporate</u>	<u>Consolidated</u>
	<i>(Dollars in thousands)</i>			
<b>Three Months Ended September 30, 2007</b>				
Net revenue	\$ 50,864	\$ 6,018	\$ —	\$ 56,882
Operating expenses	31,925	5,594	5,425	42,944
Operating income (loss) before depreciation, amortization, and (gain) loss on disposal of assets	18,939	424	(5,425)	13,938
Depreciation	2,464	181	281	2,926
Amortization	23	721	4	748
Operating income (loss) before gain (loss) on disposal of assets and income taxes	<u>\$ 16,452</u>	<u>\$ (478)</u>	<u>\$ (5,710)</u>	<u>\$ 10,264</u>
<b>Three Months Ended September 30, 2008</b>				
Net revenue	\$ 47,371	\$ 7,057	\$ —	\$ 54,428
Operating expenses	30,942	6,477	6,555	43,974
Impairment of long-lived assets	20,320	—	—	20,320
Operating income (loss) before depreciation, amortization, and (gain) loss on disposal of assets	(3,891)	580	(6,555)	(9,866)
Depreciation	2,729	455	322	3,506
Amortization	3	705	4	712
Operating loss before gain (loss) on disposal of assets and income taxes	<u>\$ (6,623)</u>	<u>\$ (580)</u>	<u>\$ (6,881)</u>	<u>\$ (14,084)</u>

NOTE 15. SEGMENT DATA (CONTINUED)

	<u>Radio Broadcast</u>	<u>Non-broadcast</u>	<u>Corporate</u>	<u>Consolidated</u>
<i>(Dollars in thousands)</i>				
<b>Nine Months Ended September 30, 2007</b>				
Net revenue	\$ 153,001	\$ 17,480	\$ —	\$ 170,481
Operating expenses	96,423	15,903	16,735	129,061
Operating income (loss) before depreciation, amortization, and (gain) loss on disposal of assets	56,578	1,577	(16,735)	41,420
Depreciation	7,531	470	844	8,845
Amortization	113	2,207	14	2,334
Operating income (loss) before gain (loss) on disposal of assets and income taxes	<u>\$ 48,934</u>	<u>\$ (1,100)</u>	<u>\$ (17,593)</u>	<u>\$ 30,241</u>

<b>Nine Months Ended September 30, 2008</b>				
Net revenue	\$ 145,226	\$ 20,711	\$ —	\$ 165,937
Operating expenses	94,634	19,564	16,314	130,512
Impairment of long-lived assets	20,320	—	—	20,320
Operating income (loss) before depreciation, amortization, and (gain) loss on disposal of assets	30,272	1,147	(16,314)	15,105
Depreciation	7,918	1,100	965	9,983
Amortization	40	2,003	10	2,053
Operating income (loss) before gain (loss) on disposal of assets and income taxes	<u>\$ 22,314</u>	<u>\$ (1,956)</u>	<u>\$ (17,289)</u>	<u>\$ 3,069</u>

	<u>Radio Broadcast</u>	<u>Non-broadcast</u>	<u>Corporate</u>	<u>Consolidated</u>
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*(Dollars in thousands)*

**December 31, 2007**

Total property, plant and equipment, net	\$ 114,795	\$ 5,524	\$ 10,538	\$ 130,857
Goodwill	4,858	13,770	8	18,636

**September 30, 2008**

Total property, plant and equipment, net	\$ 120,180	\$ 6,227	\$ 10,157	\$ 136,564
Goodwill	4,848	13,861	8	18,717

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

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>
<i>(Dollars in thousands)</i>				
Operating income before depreciation, amortization, and gain (loss) on disposal of assets	\$ 13,938	\$ (9,866)	\$ 41,420	\$ 15,105
Depreciation expense	(2,926)	(3,506)	(8,845)	(9,983)
Amortization expense	(748)	(712)	(2,334)	(2,053)
Gain (loss) on disposal of assets	(309)	(142)	2,329	5,862
Interest income	52	47	160	181
Interest expense	(6,375)	(5,453)	(19,137)	(17,015)
Other income (expense), net	83	278	230	178
Income (loss) from continuing operations before income taxes	<u>\$ 3,715</u>	<u>\$ (19,354)</u>	<u>\$ 13,823</u>	<u>\$ (7,725)</u>

**NOTE 16. CONSOLIDATING FINANCIAL INFORMATION**

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 “7¾ % 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 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 CCM Communications, Inc. (“CCM”) are 100% owned by Salem and Salem Holding owns 100% of all of its subsidiaries. CCM and all subsidiaries of Salem Holding are guarantors. 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 September 30, 2008, amounted to \$319.5 million. Included in intercompany receivables of Salem Holding presented in the consolidating balance sheet below is \$18.5 million of amounts due from CCM as of September 30, 2008.

SALEM COMMUNICATIONS CORPORATION  
CONDENSED CONSOLIDATING BALANCE SHEETS  
(UNAUDITED)  
(Dollars in thousands)

	As of September 30, 2008				
	Guarantors		Issuer and Guarantor Subsidiaries	Adjustments	Salem Consolidated
	Parent	CCM	Salem Holding		
<b>Current Assets:</b>					
Cash and cash equivalents	\$ —	\$ 52	\$ 132	\$ —	\$ 184
Trade accounts receivable, net	—	153	29,590	—	29,743
Other receivables	—	1	342	—	343
Prepaid expenses	—	141	2,667	—	2,808
Deferred income taxes	—	160	5,021	—	5,181
Assets held for sale	—	—	204	—	204
<b>Total current assets</b>	<b>—</b>	<b>507</b>	<b>37,956</b>	<b>—</b>	<b>38,463</b>
Investment in subsidiaries	313,531	—	—	(313,531)	—
Property, plant and equipment, net	—	642	135,922	—	136,564
Broadcast licenses	—	—	452,109	—	452,109
Goodwill	—	712	18,005	—	18,717
Other indefinite-lived intangible assets	—	2,892	—	—	2,892
Amortizable intangible assets, net	—	555	4,643	—	5,198
Bond issue costs	—	—	333	—	333
Bank loan fees	—	—	1,235	—	1,235
Intercompany receivables	20,085	—	98,197	(118,282)	—
Notes receivable	—	—	2,948	—	2,948
Other assets	—	20	7,089	—	7,109
<b>Total assets</b>	<b>\$ 333,616</b>	<b>\$ 5,328</b>	<b>\$ 758,437</b>	<b>\$ (431,813)</b>	<b>\$ 665,568</b>
<b>Current liabilities:</b>					
Accounts payable	\$ —	\$ 22	\$ 948	\$ —	\$ 970
Accrued expenses	—	403	5,763	—	6,166
Accrued compensation and related expenses	—	191	7,043	—	7,234
Accrued interest	—	—	4,344	—	4,344
Deferred revenue	—	2,124	4,040	—	6,164
Income tax payable	—	5	29	—	34
Current maturities of long-term debt	—	—	3,751	—	3,751
<b>Total current liabilities</b>	<b>—</b>	<b>2,745</b>	<b>25,918</b>	<b>—</b>	<b>28,663</b>
Intercompany payables	99,739	18,543	—	(118,282)	—
Long-term debt	—	—	332,193	—	332,193
Fair value of interest rate swap agreements	—	—	3,290	—	3,290
Deferred income taxes	345	(9,995)	68,395	—	58,745
Deferred revenue	—	25	7,736	—	7,761
Other liabilities	—	—	1,384	—	1,384
<b>Total stockholders' equity</b>	<b>233,532</b>	<b>(5,990)</b>	<b>319,521</b>	<b>(313,531)</b>	<b>233,532</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 333,616</b>	<b>\$ 5,328</b>	<b>\$ 758,437</b>	<b>\$ (431,813)</b>	<b>\$ 665,568</b>

**NOTE 16. CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)**

SALEM COMMUNICATIONS CORPORATION  
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS  
(UNAUDITED)  
(Dollars in thousands)

	As of September 30, 2008				
	Guarantors		Issuer and Guarantor Subsidiaries		Salem Consolidated
	Parent	CCM	Salem Holding	Adjustments	
Net broadcast revenue	\$ —	\$ —	\$ 145,643	\$ (417)	\$ 145,226
Non-broadcast revenue	—	4,484	16,417	(190)	20,711
<b>Total revenue</b>	<b>—</b>	<b>4,484</b>	<b>162,060</b>	<b>(607)</b>	<b>165,937</b>
Operating expenses:					
Broadcast operating expenses	—	—	94,620	14	94,634
Non-broadcast operating expenses	—	5,797	14,388	(621)	19,564
Corporate expenses	—	—	16,314	—	16,314
Depreciation	—	185	9,798	—	9,983
Amortization	—	408	1,645	—	2,053
Impairment of long-lived assets	—	—	20,320	—	20,320
(Gain) loss on disposal of assets	—	23	(5,885)	—	(5,862)
<b>Total operating expenses</b>	<b>—</b>	<b>6,413</b>	<b>151,200</b>	<b>(607)</b>	<b>157,006</b>
<b>Operating income (loss)</b>	<b>—</b>	<b>(1,929)</b>	<b>10,860</b>	<b>—</b>	<b>8,931</b>
Operating income (expense):					
Equity in earnings of consolidated subsidiaries, net	(943)	—	—	943	—
Interest income	3,093	—	63,139	(66,051)	181
Interest expense	(5,768)	(956)	(76,342)	66,051	(17,015)
Other income, net	—	—	178	—	178
<b>Income (loss) before income taxes</b>	<b>(3,618)</b>	<b>(2,885)</b>	<b>(2,165)</b>	<b>943</b>	<b>(7,725)</b>
Provision (benefit from) for income taxes	(1,123)	(1,147)	(830)	—	(3,100)
<b>Income (loss) from continuing operations, net of tax</b>	<b>(2,495)</b>	<b>(1,738)</b>	<b>(1,335)</b>	<b>943</b>	<b>(4,625)</b>
Income from discontinued operations, net of tax	—	57	2,073	—	2,130
<b>Net income (loss)</b>	<b>\$ (2,495)</b>	<b>\$ (1,681)</b>	<b>\$ 738</b>	<b>\$ 943</b>	<b>\$ (2,495)</b>
Other comprehensive income (loss)	(480)	—	(480)	480	(480)
<b>Comprehensive income (loss)</b>	<b>\$ (2,975)</b>	<b>\$ (1,681)</b>	<b>\$ 258</b>	<b>\$ 1,423</b>	<b>\$ (2,975)</b>

## 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 4 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 94 radio stations in 38 markets, including 59 stations in 23 of the top 25 markets, which consists of 28 FM stations and 66 AM stations. We are one of only four commercial radio broadcasters with radio stations in all of the top 10 markets. We are the seventh 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 recently introduced a fourth strategic format, Spanish Christian Teaching and Talk on a small number of stations. The Spanish Christian Teaching and Talk format is similar to our core Christian Teaching and Talk format in that it broadcasts biblically based programming, however, almost all of the block programming is local rather than national. 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 12 U.S. cities.

We also own *Salem Web Network*™ ("SWN") and *Townhall*®.com, that we believe to be a premiere Internet platform serving the audience interested in Christian and conservative content. SWN's content, both in text and audio, can be accessed through our national portals which include OnePlace.com, Crosswalk.com, Christianity.com, Townhall.com, and through our radio station websites, which provide local content of interest to our local radio station listeners. We also own *Salem Publishing*™, a magazine publisher serving the Christian audience, as well as Xulon Press, a provider of print-on-demand publishing services targeted to the Christian audience.

Our principal business strategy is to improve our national radio platform and to invest in and build non-broadcast businesses as the breadth of the media marketplace also expands to deliver compelling content to audiences interested in Christian and family-themed programming and conservative news talk. Our national presence in broadcasting, Internet and publishing gives advertisers a platform that is a unique and powerful way to reach Christian audiences. We program 41 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 24 News Talk and 12 Contemporary Christian Music stations and six of our stations in Spanish-language Christian Teaching and Talk format. 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 and books that target similar audiences in order to provide cross-platform synergies.

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

## OVERVIEW

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

Historically, our principal sources of our broadcast 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.

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.

Our broadcast 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.

Arbitron has developed new technology to collect data for its ratings service. The Portable People Meter™ (PPM™) is a small, pager-sized 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 more markets in the future. It is not yet clear what impact, if any, the introduction of the PPM will have on our revenues for stations which subscribe to Arbitron.

As is typical in the radio broadcast 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 because block program rates are generally set annually and recognized on a per program basis.

Our cash flow has historically been 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 broadcast 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. During 2007, we sold 97% 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.

#### **KNOWN TRENDS AND UNCERTAINTIES**

Domestic radio revenues have continued to decline during 2008. We believe this is primarily the result of the struggling United States economy and corresponding reductions in discretionary advertising spending by our customers. Our advertising revenue has been negatively impacted by declining advertising from our customers, particularly in the financial services and auto industries. We expect this trend to continue, however, we cannot quantify the financial impact on our future operating results. In response to these economic challenges, we have initiated several cost reduction strategies including (1) reducing headcount, (2) temporarily suspending the Company match on 401(k) contributions as of July 2008, (3) temporarily suspending the management bonus program, (4) requiring all employees to use accrued vacation balances by March 31, 2009, (5) limiting capital expenditures and (6) implementing pay freezes as of the fourth quarter of 2008. We continue to pursue opportunities to sell assets, particularly stations that are in non-strategic formats and/or are underperforming, the proceeds of which may be used to pay down debt.

This period of economic uncertainty increases our exposure to several risks, including but not limited to:

- Substantially increasing our exposure to interest expense due to some of our indebtedness being at a variable rate of interest and the cost of refinancing our debt if we are unable to meet key financial and liquidity ratios;
- Increasing pressure to sell advertising and block programming time at discounted rates;
- An increase in uncollectible accounts as our customers face tight credit markets;
- Ministries are experiencing lower level of donations that could negatively impact their ability to purchase and pay for block programming time;
- Limiting our ability to obtain additional financing to fund working capital, capital expenditures, acquisitions and other corporate requirements; and
- Impairment losses on the value of our FCC licenses and other long-lived intangible assets including goodwill .

#### **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			Nine Months Ended		
	September 30,		% Change	September 30,		% Change
	2007	2008		2007	2008	
	<i>(Dollars in thousands)</i>					
Net broadcast revenue	\$ 50,864	\$ 47,371	(6.9)%	\$ 153,001	\$ 145,226	(5.1)%
Non-broadcast revenue	6,018	7,057	17.3%	17,480	20,711	18.5%
Total revenue	56,882	54,428	(4.3)%	170,481	165,937	(2.7)%
Operating expenses:						
Broadcast operating expenses	31,925	30,942	(3.1)%	96,423	94,634	(1.9)%
Non-broadcast operating expenses	5,594	6,477	15.8%	15,903	19,564	23.0%
Corporate expenses	5,425	6,555	20.8%	16,735	16,314	(2.5)%
Depreciation	2,926	3,506	19.8%	8,845	9,983	12.9%
Amortization	748	712	(4.8)%	2,334	2,053	(12.0)%
Impairment of long-lived assets	—	20,320	100.0%	—	20,320	100.0%
(Gain) loss on disposal of assets	309	142	(54.0)%	(2,329)	(5,862)	151.7%
Total operating expenses	46,927	68,654	46.3%	137,911	157,006	13.8%
Operating income (loss) from continuing operations	9,955	(14,226)	(242.9)%	32,570	8,931	(72.6)%
Other income (expense):						
Interest income	52	47	(9.6)%	160	181	13.1%
Interest expense	(6,375)	(5,453)	(14.5)%	(19,137)	(17,015)	(11.1)%
Other income, net	83	278	234.9%	230	178	(22.6)%
Income (loss) from continuing operations before income taxes	3,715	(19,354)	(621.0)%	13,823	(7,725)	(155.9)%
Provision for (benefit from) income taxes	1,698	(8,235)	(585.0)%	6,035	(3,100)	(151.4)%
Income (loss) from continuing operations	2,017	(11,119)	(651.3)%	7,788	(4,625)	(159.4)%
Income from discontinued operations, net of tax	81	77	(4.9)%	199	2,130	970.3%
Net income (loss)	\$ 2,098	\$ (11,042)	(626.3)%	\$ 7,987	\$ (2,495)	(131.2)%

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2008	2007	2008
Net broadcast revenue	90 %	87 %	90 %	88 %
Non-broadcast revenue	10 %	13 %	10 %	12 %
Total revenue	100 %	100 %	100 %	100 %
Operating expenses:				
Broadcast operating expenses	56 %	57 %	57 %	57 %
Non-broadcast operating expenses	9 %	12 %	9 %	12 %
Corporate expenses	10 %	12 %	10 %	10 %
Depreciation	5 %	7 %	5 %	6 %
Amortization	1 %	1 %	1 %	1 %
Impairment of long-lived assets	— %	37 %	— %	12 %
(Gain) loss on disposal of assets	1 %	— %	(2) %	(3) %
Total operating expenses	82 %	126 %	80 %	95 %
Operating income (loss) from continuing operations	18 %	(26) %	20 %	5 %
Other income (expense):				
Interest income	— %	— %	— %	— %
Interest expense	(10) %	(10) %	(11) %	(10) %
Other income, net	— %	— %	— %	— %
Income (loss) from continuing operations before income taxes	8 %	(36) %	9 %	(5) %
Provision for (benefit from) income taxes	3 %	(15) %	4 %	(2) %
Income (loss) from continuing operations	5 %	(21) %	5 %	(3) %
Discontinued operations, net of tax	— %	— %	— %	1 %
Net income (loss)	5 %	(21) %	5 %	(2) %

**Three months ended September 30, 2008 compared to three months ended September 30, 2007**

**NET BROADCAST REVENUE.** Net broadcast revenue decreased \$3.5 million, or 6.9%, to \$47.4 million for the three months ended September 30, 2008, from \$50.9 million for the same period of the prior year. On a same station basis, net broadcast revenue declined \$3.4 million, or 6.9%, to \$45.5 million for the three months ended September 30, 2008, from \$48.9 million for the same period of the prior year. The decline in revenue includes a \$3.2 million combined decrease in local spot sales on all of our radio station formats, a \$0.8 million decline in national block programming revenue on our Christian Teaching and Talk stations and a \$0.2 million decline in infomercial revenue on our Christian Teaching and Talk stations partially offset by a \$0.5 million increase in program revenue on our new Spanish Christian Teaching and Talk format stations. Revenue from advertising as a percentage of our net broadcast revenue decreased to 46.2% for the three months ended September 30, 2008, from 48.4% for the same period of the prior year.

Revenue from block program time as a percentage of our net broadcast revenue increased to 38.7% for the three months ended September 30, 2008, from 37.1% for the same period of the prior year. The trend in the radio broadcasting industry is of declining advertising revenues resulting in the use of block programming or infomercials to offset the declines. Further, the growth in block programming and infomercial revenues is slowing. We expect these trends to continue; however, we cannot quantify the financial impact on our future operating results.

**NON-BROADCAST REVENUE.** Non-broadcast revenue increased \$1.1 million, or 17.3%, to \$7.1 million for the three months ended September 30, 2008, from \$6.0 million for the same period of the prior year. The growth in revenue is primarily due to a \$0.2 million increase in banner advertising and ministry streaming on OnePlace.com, a \$0.2 million increase in publishing revenue on Xulon Press and a \$0.2 million increase in revenue from our Townhall.com website. Additionally, we generated revenue of \$0.4 million from our radio station websites that were redesigned and launched beginning in the second half of 2007.

**BROADCAST OPERATING EXPENSES.** Broadcast operating expenses decreased \$1.0 million, or 3.1%, to \$30.9 million for the three months ended September 30, 2008, from \$31.9 million for the same period of the prior year. On a same station basis, broadcast operating expense decreased \$1.3 million, or 4.0%, to \$29.0 million for the three months ended September 30, 2008, compared to \$30.3 million for same period of the prior year. The decline in broadcast operating expenses is primarily due to reduced expenses,

such as commissions, that vary with revenue and reduction in headcount. Specifically, the decline included a \$1.4 million reduction in salary and commission expenses, a \$0.5 million reduction in advertising and promotion expenses, offset by a \$0.4 million increase in bad debt expenses and a \$0.4 million increase in facility-related expenses due to higher utility costs and higher rents associated with lease renewals in the New York and Boston markets.

*NON-BROADCAST OPERATING EXPENSES.* Non-broadcast operating expenses increased \$0.9 million, or 15.8%, to \$6.5 million for the three months ended September 30, 2008, compared to \$5.6 million for the same period of the prior year. The increase includes a \$0.3 million increase in advertising and promotion costs, \$0.2 million in costs associated with Townhall Magazine, a new publication launched in early 2008, and a \$0.3 million increase in net costs associated with operating and maintaining websites, including radio station websites.

*CORPORATE EXPENSES.* Corporate expenses increased \$1.2 million, or 20.8%, to \$6.6 million for the three months ended September 30, 2008, compared to \$5.4 million for the same period of the prior year. The increase consists of \$1.6 million in non-cash stock-based compensation associated with the accelerated expensing of unvested options that were voluntarily surrendered by senior management in September 2008, a \$0.4 million increase in salary expense associated with employee severance packages offered through our staff reduction efforts partially offset by a \$0.4 million decrease in non-cash stock based compensation primarily due to a reduction in grants offered to employees, and a \$0.2 million decrease in travel and entertainment expenses.

*DEPRECIATION.* Depreciation expense increased \$0.6 million, or 19.8%, to \$3.5 million for the three months ended September 30, 2008, compared to \$2.9 million for the same period of the prior year. The increase is due to the purchase of capital expenditures associated with computer software and office equipment that typically carry a shorter economic useful life of three to ten years compared to broadcasting towers and leasehold improvements.

*AMORTIZATION.* Amortization expense was \$0.7 million for the three months ended September 30, 2008 and 2007.

*IMPAIRMENT OF LONG-LIVED ASSETS.* We recognized a loss of \$20.3 million associated with the decline in fair value of our broadcast licenses in the Cleveland, Ohio market in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets."

*LOSS ON DISPOSAL OF ASSETS.* The loss on disposal of assets of \$0.3 million for the three months ended September 30, 2008 and \$0.1 million for the same period of the prior year was comprised of various fixed assets and equipment disposals.

*OTHER INCOME (EXPENSE).* Interest income of \$47,000 for the three months ended September 30, 2008 and \$52,000 for the same period of the prior year was interest earned on excess cash. Interest expense decreased \$0.9 million, or 14.5%, to \$5.5 million for the three months ended September 30, 2008, compared to \$6.4 million for the same period of the prior year due to a lower outstanding revolving debt balance as well as lower interest rates. Other income, net of \$0.3 million for the three months ended September 30, 2008 consists of non-recurring reimbursements received, including \$0.2 million associated with the terminated sale of KKMO-AM in Seattle, Washington, offset with bank commitment fees associated with our credit facilities. Other income, net of \$0.1 million for the three months ended September 30, 2007 consists of a non-recurring royalty payment from real estate properties offset by bank commitment fees associated with our credit facilities.

*PROVISION FOR (BENEFIT FROM) INCOME TAXES.* We adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48") as of January 1, 2007. Benefit from income taxes was \$8.2 million for the three months ended September 30, 2008 compared to a provision for \$1.7 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 42.5% for the three months ended September 30, 2008 compared to 45.7% 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 FROM DISCONTINUED OPERATIONS, NET OF TAX.* The income from discontinued operations of \$0.1 million, net of taxes, for the three months ended September 30, 2008 and for the same period of the prior year, includes the operating results of WFZH-FM, Milwaukee, through the date of sale, and the operating results of WRFD-AM in Columbus, Ohio.

*NET INCOME (LOSS).* We recognized a net loss of \$11.0 million for the three months ended September 30, 2008 compared to net income of \$2.1 million for the same period of the prior year. The decrease of \$13.1 million is due primarily to the \$20.3 million impairment of long-lived assets and a \$4.0 million decrease in operating income exclusive of the impairment loss offset by a \$9.9 million favorable impact on the income tax provision as a result of the impairment loss.

*Nine months ended September 30, 2008 compared to nine months ended September 30, 2007*

**NET BROADCAST REVENUE.** Net broadcast revenue decreased \$7.8 million, or 5.1%, to \$145.2 million for the nine months ended September 30, 2008, from \$153.0 million for the same period of the prior year. On a same station basis, net broadcast revenue declined \$8.1 million, or 5.5%, to \$140.1 million for the nine months ended September 30, 2008, from \$148.2 million for the same period of the prior year. The decline in revenue includes a \$7.2 million combined decrease in local spot sales on all of our radio station formats and a \$2.0 million decline in national block programming revenue on our Christian Teaching and Talk stations, offset by a \$1.8 million increase in revenue on our new Spanish Christian Teaching and Talk stations, a \$0.9 million combined increase in local program revenue across all of our radio station formats, \$0.6 million increase in political advertising revenue on the local and national level, a \$0.3 million increase in infomercial revenue and \$0.4 million increase in national program revenue on our News Talk stations. Revenue from advertising as a percentage of our net broadcast revenue decreased to 46.3% for the nine months ended September 30, 2008, from 48.8% for the same period of the prior year. Revenue from block program time as a percentage of our net broadcast revenue increased to 38.1% for the nine months ended September 30, 2008, from 36.7% for the same period of the prior year. The trend in the radio broadcasting industry is of declining advertising revenues resulting in the use of block programming or infomercials to offset the declines. Additionally, the growth of block programming and infomercial revenue has slowed. We expect these trends to continue; however, we cannot quantify the financial impact on our future operating results.

**NON-BROADCAST REVENUE.** Non-broadcast revenue increased \$3.2 million, or 18.5%, to \$20.7 million for the nine months ended September 30, 2008, from \$17.5 million for the same period of the prior year. The increase is primarily due to a \$0.8 million increase in revenue on Xulon Press, a \$0.3 million increase in banner advertising on Townhall.com, a \$0.7 million increase in ministry streaming and banner advertising revenue on OnePlace.com, and \$0.2 million of revenue from Salem Consumer Products, an entity established in the second half of 2007. Additionally, we generated revenue of \$1.2 million from our radio station websites that were redesigned and launched beginning in the second half of 2007.

**BROADCAST OPERATING EXPENSES.** Broadcast operating expenses decreased \$1.8 million, or 1.9%, to \$94.6 million for the nine months ended September 30, 2008, from \$96.4 million for the same period of the prior year. On a same station basis, broadcast operating expense decreased \$2.9 million, or 3.1%, to \$89.7 million for the nine months ended September 30, 2008, compared to \$92.6 million for the same period of the prior year. The decline in broadcast operating expenses is comprised of a \$3.1 million decrease in advertising expenses, a \$2.3 million decrease in personnel related costs and a \$0.2 million decrease in national commissions associated with lower revenues, partially offset by a \$1.2 million increase in bad debt expense, \$0.3 million increase in production and programming, \$0.2 million increase in LMA fees associated with operating radio station KTRO-AM in Portland, Washington, a \$0.4 increase in music license fees, and a \$1.1 million increase in facility related expenses due primarily to higher utility costs and rental fees associated with lease renewals in the New York and Boston markets.

**NON-BROADCAST OPERATING EXPENSES.** Non-broadcast operating expenses increased \$3.7 million, or 23.0%, to \$19.6 million for the nine months ended September 30, 2008, compared to \$15.9 million for the same period of the prior year. The increase is comprised of a \$0.7 million of costs associated with Townhall Magazine, a new publication launched in early 2008, a \$0.5 million increase in production and administrative costs on Xulon Press, a \$0.4 million increase in personnel related costs on Townhall.com, \$0.2 million increase in costs associated with operating Salem Consumer Products, a new entity launched during the second half of 2007. OnePlace.com had \$0.7 million increase in advertising costs, a \$0.1 million increase in personnel related costs and \$0.2 million increase in computer software and licenses. Additionally, we generated expenses of \$1.1 million from our radio station websites that were redesigned and launched beginning in the second half of 2007.

**CORPORATE EXPENSES.** Corporate expenses decreased \$0.4 million, or 2.5%, to \$16.3 million for the nine months ended September 30, 2008, compared to \$16.7 million for the same period of the prior year. The decrease is attributable to an overall cost reduction initiative, that includes a reduction in headcount and lower personnel related costs of \$0.9 million, a decrease of \$0.5 million in stock based compensation expense due to no new grants being offered to employees and a decrease of \$0.2 million in accounting service fees and public reporting costs, offset by a \$1.6 million increase in non-cash stock-based compensation expense associated with the accelerated expensing of unvested options voluntarily surrendered by members of senior management in September 2008.

**DEPRECIATION.** Depreciation expense increased \$1.2 million, or 12.9%, to \$10.0 million for the nine months ended September 30, 2008, compared to \$8.8 million for the same period of the prior year. The increase is due to capital expenditures, including \$5.5 million during the year ended December 31, 2007, that are primarily associated with computer software and office equipment that have shorter estimated useful lives from three to ten years as compared to capital expenditures for buildings and towers with a thirty year estimated life.

**AMORTIZATION.** Amortization expense decreased \$0.2 million, or 12.0%, to \$2.1 million for the nine months ended September 30, 2008, compared to \$2.3 million for the same period of the prior year. The decrease is due to higher amortization recognized in

early 2007 on intangible assets such as advertising agreements and other business contracts that were acquired in 2006 with an estimated useful life of one year.

*(GAIN) LOSS ON DISPOSAL OF ASSETS.* Gain on disposal of assets of \$5.9 million for the nine months ended September 30, 2008 was primarily comprised of the sale of radio station KTEK, Houston, Texas for \$7.8 million resulting in a pre-tax gain of \$6.1 million, partially offset by various fixed assets disposals. A gain on disposal of assets of \$2.3 million for the same period of the prior year was comprised of the sale of selected assets of WKNR-AM in Cleveland, Ohio, for \$7.0 million which resulted in a pre-tax gain of \$3.4 million offset by the loss recognized on the sale of radio station WVRY-FM, Nashville, Tennessee for \$0.9 million resulting in a pre-tax loss of \$0.5 million and additional various fixed asset disposals.

*IMPAIRMENT OF LONG-LIVED ASSETS.* We recognized a loss of \$20.3 million associated with the decline in fair value of our broadcast licenses in the Cleveland, Ohio market in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets."

*OTHER INCOME (EXPENSE).* Interest income remained consistent at \$0.2 million for the nine months ended September 30, 2008 and the same period of the prior year. Interest expense decreased \$2.1 million, or 11.1%, to \$17.0 million for the nine months ended September 30, 2008, compared to \$19.1 million for the same period of the prior year due to a lower net outstanding debt balance and lower interest rates. Other income, net, of \$0.2 million for the nine months ended September 30, 2008 consists of non-recurring reimbursements received, including \$0.2 million associated with the terminated sale of KKMO-AM in Seattle, Washington, offset with bank commitment fees associated with our credit facilities. Other income, net of \$0.2 million for the nine months ended September 30, 2007 consisted primarily of royalty income from real estate properties offset with bank commitment fees associated with the credit facilities.

*PROVISION FOR (BENEFIT FROM) INCOME TAXES.* We adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48") as of January 1, 2007. Benefit from income taxes was \$3.1 million for the nine months ended September 30, 2008 compared to a provision for \$6.0 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 40.1% for the nine months ended September 30, 2008 compared to 43.7% 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 FROM DISCONTINUED OPERATIONS, NET OF TAX.* The income from discontinued operations of \$2.1 million, net of taxes, for the nine months ended September 30, 2008 includes the pre-tax gain of \$0.2 million on the sale of WRRD-AM, Milwaukee, Wisconsin, a \$1.4 million pre-tax gain on the sale of WFZH-FM, Milwaukee, Wisconsin, operating results of WRFD-AM in Columbus, Ohio, and operating results of *CCM Magazine*. The amount reported for the same period of the prior year includes only the operating results of these entities as of the period end without the impact of the gain from the sale.

*NET INCOME (LOSS).* We recognized a net loss of \$2.5 million for the nine months ended September 30, 2008 compared to net income of \$8.0 million for the same period of the prior year. This change of \$10.5 million is primarily due to the \$20.3 million impairment of long lived intangible assets and a \$3.4 million decrease in operating income exclusive of the impairment loss, offset by the favorable impact of the loss on our tax provision of \$9.1 million, a \$2.1 million decrease in interest expense, \$3.6 million increase in gain on disposal of assets and a \$1.9 million increase in income from discontinued operations.

#### **NON-GAAP FINANCIAL MEASURES**

The performance of a radio broadcast 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 expenses, as explained above, have a direct impact on changes in SOI.

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

prepared in accordance with GAAP. SOI as defined by and used by our company is not necessarily comparable to similarly titled measures employed by other companies.

**Three months ended September 30, 2008 compared to the three months ended September 30, 2007**

**STATION OPERATING INCOME.** SOI decreased \$2.5 million, or 13.3%, to \$16.4 million for the three months ended September 30, 2008, compared to \$18.9 million for the same period of the prior year. As a percentage of net broadcast revenue, SOI decreased to 34.7% for the three months ended September 30, 2008 from 37.2% for the same period of the prior year. On a same station basis, SOI decreased \$2.2 million, or 11.6%, to \$16.5 million for the three months ended September 30, 2008 from \$18.7 million for the same period of the prior year. As a percentage of same station net broadcast revenue, same station SOI decreased to 36.2% for the three months ended September 30, 2008 compared to 38.1% for the same period of the prior year.

**Nine months ended September 30, 2008 compared to the nine months ended September 30, 2007**

**STATION OPERATING INCOME.** SOI decreased \$6.0 million, or 10.6%, to \$50.6 million for the nine months ended September 30, 2008, compared to \$56.6 million for the same period of the prior year. As a percentage of net broadcast revenue, SOI decreased to 34.8% for the nine months ended September 30, 2008 from 37.0% for the same period of the prior year. On a same station basis, SOI decreased \$5.2 million, or 9.4%, to \$50.4 million for the nine months ended September 30, 2008 from \$55.6 million for the same period of the prior year. As a percentage of same station net broadcast revenue, same station SOI decreased to 36.0% for the nine months ended September 30, 2008 compared to 37.5% for the same period of the prior year.

The following table provides a reconciliation of SOI (a non-GAAP financial measure) to operating income (as presented in our financial statements) for the three and nine months ended September 30, 2008 and 2007:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>
	<i>(Dollars in thousands)</i>			
Station operating income	\$ 18,939	\$ 16,429	\$ 56,578	\$ 50,592
Plus non-broadcast revenue	6,018	7,057	17,480	20,711
Less non-broadcast operating expenses	(5,594)	(6,477)	(15,903)	(19,564)
Less corporate expenses	(5,425)	(6,555)	(16,735)	(16,314)
Less depreciation and amortization	(3,674)	(4,218)	(11,179)	(12,036)
Less impairment of long-lived assets	—	(20,320)	—	(20,320)
Plus gain (loss) on disposal of assets	(309)	(142)	2,329	5,862
Operating income (loss)	\$ 9,955	\$ (14,226)	\$ 32,570	\$ 8,931

**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to allowance for doubtful accounts, acquisitions and upgrades of radio station and network assets, goodwill and other intangible assets, income taxes, and long-term debt and debt covenant compliance. 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 which affect the preparation of our condensed consolidated financial statements.

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

A majority of our radio station acquisitions are acquisitions of selected assets and not acquisitions of businesses. Such asset 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 FCC license. It is our policy generally to retain third-party appraisers to value radio stations, networks or non-broadcast properties. The allocations assigned to acquired FCC 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 which 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 the radio station, network or non-broadcast properties at the close of the transaction.

We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC 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, we write-off the capitalized costs of the project.

#### ***Revenue recognition***

We recognize revenue when persuasive 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.

Revenue from radio programs and commercial advertising is recognized when the program or commercial 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 from our non-broadcast businesses is recognized when the products are shipped and the services are rendered. Revenues from the sale of advertising in our publications are recognized upon publication. Revenues from the sale of subscriptions to our publications are recognized over the life of the subscription. Revenues from book sales are recorded by when shipment occurs.

Advertising by the radio stations exchanged for goods and services is recorded as the advertising is broadcast and is valued at the estimated value of goods or services received or to be received. The value of the goods and services received in such barter transactions is charged to expense when used. We record broadcast advertising provided in exchange for goods and services as broadcast revenue and the goods or services received in exchange for such advertising as broadcast operating expenses.

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

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. An analysis is performed by applying various percentages based on the age of the receivable and other subjective and historical analysis. A considerable amount of judgment is required in assessing the likelihood of ultimate realization of these receivables including the current creditworthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. As economic conditions within the United States continue to deteriorate, our customers may experience increasing difficulties in making payments. We will continue to monitor our estimates and record additional reserves as deemed appropriate.

#### ***Goodwill and other non-amortizable intangible assets***

Approximately 71% of our total assets consist of non-amortizable intangible assets, such as FCC 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. FCC licenses are renewed 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 FCC licenses have been renewed at the end of their respective periods, and we expect that all FCC licenses will continue to be renewed in the future. Accordingly, we consider our broadcast licenses to be indefinite-lived intangible assets in accordance with SFAS No.142, "Goodwill and Other Intangible Assets." 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. The unit of accounting used to test broadcast licenses is the cluster level, which the Company defines as a group of radio stations operating in the same geographic market, sharing the same building and equipment and being managed by a single general manager. Goodwill and mastheads, attributable primarily to our non-broadcast operating segment, are tested at the business unit level, which the Company defines by publication or website.

We complete our annual impairment tests in the fourth quarter of each year. However, based on deteriorating macro-economic factors, including declining radio industry revenues during 2008 and a weakening in prevailing radio station transaction multiples, we concluded that, in connection with preparing our financial statements for the period ended September 30, 2008, an interim valuation pursuant to SFAS No. 142 was appropriate. We reviewed the financial performance of certain accounting units against established internal benchmarks. For selected accounting units that did not meet the internal benchmarks, Bond & Pecaro, an independent third party appraisal and valuation firm was engaged to perform an appraisal of the indefinite-lived asset(s). The accounting units selected were based on declines in projected market revenues and market analysis from industry experts that indicate a more than remote likelihood that a current fair value determination would be less than the carrying value. As a result of our interim review and valuation, we recorded a pre-tax impairment charge of \$20.3 million associated with the value of broadcast licenses in the Cleveland market cluster.

The valuation of intangible assets is subjective and based on estimates rather than precise calculations. If actual future results are not consistent with the assumptions and estimates used, we may be exposed to impairment charges in the future.

#### ***Uncertain tax positions***

We adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48") on January 1, 2007 and accrued liabilities for unrecognized tax benefits in accordance with the provisions. On the date of adoption we had \$3.0 million in liabilities related to uncertain tax positions, including \$0.9 million recognized under "SFAS No. 5" "Accounting for Contingencies" and carried forward from prior years and \$2.1 million recognized upon adoption of FIN 48 as a reduction to retained earnings. Included in the \$2.1 million accrual was \$0.1 million related interest, net of federal income tax benefits. During 2007, we recognized a net increase of \$0.9 million in liabilities and at December 31, 2007, had \$3.9 million in liabilities for unrecognized tax benefits. Included in this liability amount were \$0.1 million accrued for the related interest, net of federal income tax benefits, and \$0.1 million for the related penalty recorded in income tax expense on our Consolidated Statements of Operations. We recorded an increase in unrecognized tax benefits of approximately \$0.1 million as of September 30, 2008.

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

For financial reporting purposes, the company has recorded a valuation allowance of \$2.3 million as of September 30, 2008, 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.

#### ***Long-term debt and debt covenant compliance***

Our classification of borrowings under our credit facilities as long-term debt on our balance sheet is based on our assessment that, under the borrowing restrictions and covenants in our credit facilities and after considering our projected operating results and cash flows for the coming year, no principal payments, other than the scheduled principal reductions in our term loan facility, will be required pursuant to the credit agreement. 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. Should our actual results differ materially from these estimates, payments may become due under our credit facilities or it may become necessary to seek an amendment to our credit facilities. Based on our management's current assessment, we do not anticipate principal payments becoming due under our credit facilities, or a further amendment of our credit facilities becoming necessary.

#### ***Stock-based compensation***

We have one stock incentive plan, The Amended and Restated 1999 Stock Incentive Plan, (the "Plan") under which stock options and restricted stock units are granted to employees, directors, officers and advisors of the company. As of September 30, 2008, a maximum of 3,100,000 shares are authorized under the Plan, of which 610,550 are outstanding and 327,897 are exercisable.

Effective January 1, 2006, we adopted SFAS No. 123(R), which requires the measurement at fair value and recognition of compensation expense for all share-based payment awards. Total stock based compensation expense for the three and nine months ended September 30, 2008 was \$2.0 million and \$3.3 million compared to \$0.9 million and \$2.5 million for the three and nine months ended September 30, 2007. Determining the appropriate fair-value model and calculating the fair value of employee stock options and rights to purchase shares under stock purchase plans at the date of grant requires judgment. We use the Black-Scholes option pricing



model to estimate the fair value of these share-based awards consistent with the provisions of SFAS No. 123(R). Option pricing models, including the Black-Scholes model, also require the use of input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return.

## LIQUIDITY AND CAPITAL RESOURCES

We have historically financed acquisitions through borrowings, including borrowings under credit facilities and, to a lesser extent, from operating cash flow and selected asset dispositions. We expect to fund future acquisitions from cash on hand, proceeds from our debt and equity offerings, borrowings under the 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 our senior subordinated notes from operating cash flow, borrowings under our credit facilities and, if necessary, proceeds from the sale of selected assets or radio stations. We believe that cash on hand, cash flow from operations, and borrowings under the credit facilities will be sufficient to permit us to meet our financial obligations, fund pending acquisitions and fund operations for at least the next twelve months. Our term loan B credit facility matures on March 31, 2010 and our 7 3/4 % senior subordinated notes mature on December 15, 2010. Given the current deterioration of the credit markets we are likely to incur significant costs and higher interest rates under new financing arrangements.

### Cash Flows

Cash and cash equivalents were \$0.2 million on September 30, 2008 compared to \$0.4 million as of December 31, 2007. Working capital was \$9.8 million on September 30, 2008 compared to \$21.8 million as of December 31, 2007. The decrease in working capital is due to the sale of \$8.6 million of current assets associated with our discontinued operations in Milwaukee, and the classification of \$7.0 million outstanding on our Revolving line of credit as current as of September 30, 2008 based on the March 31, 2009 due date.

#### *Cash Flows from Operating Activities*

During the nine months ended September 30, 2008, our cash flows from continuing operations were primarily derived from our earnings from ongoing operations prior to non-cash expenses such as depreciation, amortization, bad debt, and stock-based compensation and changes in our working capital. Net cash provided by operating activities of continuing operations was \$31.0 million for the nine months ended September 30, 2008 compared to \$25.8 million for the same period of the prior year. The increase of \$5.1 million was primarily the result of a decrease in net income (loss) from continuing operations of \$12.4 million, \$20.3 million impairment charge related to the radio broadcasting license of our Cleveland market, changes in operating assets and liabilities, including a decrease in deferred income taxes of \$7.9 million and a change in the gain on disposal of assets of \$3.5 million.

#### *Cash Flows from Investing Activities*

Our investing activities primarily relate to capital expenditures, strategic acquisitions or dispositions of radio stations assets and strategic acquisitions of non-broadcast businesses. Net cash used in investing activities was \$23.0 million for the nine months ended September 30, 2008 compared to \$5.6 million for the same period of the prior year. The increase of \$17.4 million was due to a \$5.0 million purchase of real estate from Principal Stockholders, \$12.3 million purchase of selected assets of WMCU-AM, Miami, Florida, \$2.7 million deposit on the acquisition of selected assets of radio station WAMD-AM, Baltimore, Maryland, a \$0.4 million increase in non-broadcast business purchases, a \$1.7 million decrease in proceeds from disposal of assets, partially offset by a \$3.9 million decrease in capital expenditures.

#### *Cash Flows from Financing Activities*

Our financing activities primarily relate to proceeds and repayments under our credit facilities, payments of capital lease obligations, payments of dividends and repurchases of our Class A Common Stock. Net cash used in financing activities decreased \$1.5 million for the nine months ended September 30, 2008 to \$19.0 million from \$20.5 million for the same period of the prior year. This decrease was due to a \$10.0 million payment of a special cash dividend in the prior year, net repayments of debt of \$14.2 million during the period compared to \$9.1 million in the same period of the prior year, a \$4.1 million decrease in the net borrowings on the swingline credit facility and an increase of \$1.3 million on payments of our capital lease obligations.

## Credit Facilities

Our wholly-owned subsidiary, Salem Communications Holding Corporation (“Salem Holding”), is the borrower under our credit facilities. The maximum amount that Salem Holding may borrow under our credit facilities is limited by a ratio of our consolidated total adjusted funded debt to pro forma twelve-month cash flow (the “Total Leverage Ratio”). Our credit facilities will allow us to adjust our total debt as used in such calculation by the lesser of (i) 50% of the aggregate purchase price of acquisitions of newly acquired radio stations that we reformat to a religious talk, News Talk or religious music format or (ii) \$45.0 million, and the cash flow from such stations will not be considered in the calculation of the ratio during the period in which such acquisition gives rise to an adjustment to total debt. The Total Leverage Ratio allowed under the credit facilities was 6.75 to 1 as of September 30, 2008. The ratio will decline periodically until December 31, 2009, at which point it will remain at 5.5 to 1 through the remaining term of the credit facilities. The Total Leverage Ratio under our credit facilities at September 30, 2008, on a pro forma basis, was 6.07 to 1.

We amended our credit facilities on October 24, 2007 to keep our Total Leverage Ratio covenant ratio at 6.75 to 1 through March 30, 2009. These covenant changes were effective upon the acquisition of WMCU-AM, which occurred on April 11, 2008. Additionally, the senior leverage ratio covenant increased to 5.0 to 1 and the interest coverage ratio remained at 2.0 to 1 through March 30, 2009.

The credit facilities include a \$75.0 million senior secured reducing revolving credit facility (“revolving credit facility”), a \$75.0 million term loan B facility (“term loan B facility”) and a \$165.0 million term loan C facility (“term loan C facility”). As of September 30, 2008, the borrowing capacity and aggregate commitments were \$52.5 million under our revolving credit facility, \$72.0 million under our term loan B facility and \$161.7 million under our term loan C facility. The amount we can borrow, however, is subject to certain restrictions as described below. As of September 30, 2008, we could borrow \$36.8 million under our credit facilities.

On September 30, 2008, \$72.0 million was outstanding under the term loan B facility and \$161.7 million was outstanding under the term loan C facility. The revolving credit facility matures on March 31, 2009. The borrowing capacity under the term loan B facility steps down 0.5% each December 31 and June 30. The term loan B facility matures on the earlier of March 31, 2010, or the date that is six months prior to the maturity of any subordinated indebtedness of Salem or Salem Holding. The borrowing capacity under the term loan C facility steps down 0.5% each December 31 and June 30, commencing December 31, 2008. The term loan C facility matures on the earlier of June 30, 2012, or the date that is six months prior to the maturity of any subordinated indebtedness of Salem or Salem Holding. The credit facilities require us, under certain circumstances, to prepay borrowings under the credit facilities with excess cash flow and the net proceeds from the sale of assets, the issuance of equity interests and the issuance of subordinated notes. If we are required to make these prepayments, our borrowing capacity and the aggregate commitments under the facilities will be reduced, but such reduction shall not, in any event, reduce the borrowing capacity and aggregate commitments under the facilities below \$50.0 million.

Amounts outstanding under the credit facilities bear interest at a rate based on, at Salem Holding’s option, the bank’s prime rate or LIBOR, in each case plus a spread. For purposes of determining the interest rate under our revolving credit facility, the prime rate spread ranges from 0.00% to 1.00%, and the LIBOR spread ranges from 1.00% to 2.00%. For both the term loan B facility and the term loan C facility, the prime rate spread ranges from 0.25% to 0.75%, and the LIBOR spread ranges from 1.25% to 1.75%. In each case, the spread is based on the Total Leverage Ratio on the date of determination. If an event of default occurs, the rate may increase by 2.0%. At September 30, 2008, the blended interest rate on amounts outstanding under the credit facilities was 5.31%.

Our credit facilities contain additional restrictive covenants customary for facilities of their size, type and purpose which, with specified exceptions, limits our ability to incur debt, have liens, enter into affiliate transactions, pay dividends, consolidate, merge or effect certain asset sales, make specified investments, acquisitions and loans and change the nature of our business. Our credit facilities also require us to satisfy specified financial covenants, which covenants require us on a consolidated basis to maintain specified financial ratios and comply with certain financial tests, including ratios for maximum leverage as described above, minimum interest coverage (not less than 2.0 to 1 through March 31, 2009 increasing in increments until June 30, 2009, at which point it will remain at 2.5 to 1 through the remaining term of the credit facilities), minimum debt service coverage (a static ratio of not less than 1.25 to 1), a maximum consolidated senior leverage ratio (currently 5.0 to 1, through March 31, 2009, declining periodically until December 31, 2009, at which point it will remain at 4.0 to 1 through the remaining term of the credit facilities), and minimum fixed charge coverage (a static ratio of not less than 1.1 to 1). Salem and all of its subsidiaries, except for Salem Holding, are guarantors of borrowings under the credit facilities. The credit facilities are secured by liens on all of our assets and our subsidiaries’ assets and pledges of all of the capital stock of our subsidiaries.

As of September 30, 2008, we were and remain in compliance with all of the covenants under our terms of the credit facilities.

*Swingline Credit Facility.* On June 1, 2005, we entered into an agreement for a swingline credit facility (“Swingline”) with a borrowing capacity of \$5.0 million. This agreement was amended as of June 1, 2007. As collateral for the Swingline, we pledged our corporate office building. Amounts outstanding under the Swingline bear interest at a rate based on 0.25% less than the bank’s prime rate. As of September 30, 2008, there was no outstanding balance under the Swingline.

As of September 30, 2008, we were and remain in compliance with all of the covenants under the terms of the Swingline.

*7¾% Notes.* In December 2002, Salem Holding issued \$100.0 million principal amount of 7¾% Notes. Salem Holding used the net proceeds to redeem the \$100.0 million 9½% Notes on January 22, 2003. The indenture for the 7¾% Notes contains restrictive covenants that, among other things, limit the incurrence of debt by Salem Holding and its subsidiaries, the payment of dividends, the use of proceeds of specified asset sales and transactions with affiliates. Salem Holding is required to pay \$7.8 million per year in interest on the 7¾% Notes. We and all of our subsidiaries (other than Salem Holding) are guarantors of the 7¾% Notes.

As of September 30, 2008, we were and remain in compliance with all of the covenants under the indenture for the 7¾% Notes.

**Summary of long-term debt obligations**

Long-term debt consisted of the following at the balance sheet date indicated:

	<u>As of December 31, 2007</u>	<u>As of September 30, 2008</u>
	<i>(Dollars in thousands)</i>	
Term loans under credit facility	\$ 234,900	\$ 233,667
Revolving line of credit under credit facility	13,000	—
Swingline credit facility	2,952	—
7¾% senior subordinated notes due 2010	100,000	100,000
Seller financed note to acquire Townhall.com	2,546	1,288
Capital leases and other loans	886	989
	<u>\$ 354,284</u>	<u>\$ 335,944</u>
Less current portion	<u>6,667</u>	<u>3,751</u>
	<u>\$ 347,617</u>	<u>\$ 332,193</u>

In addition to the amounts listed above, we also have interest payments related to our long-term debt as follows as of September 30, 2008:

- Outstanding borrowings of \$233.7 million on term loans with interest payments due at LIBOR plus 1.25% to 1.75% or at prime rate plus 0.25% to 0.75%, depending on our Total Leverage Ratio;
- Swingline credit facility with interest payments due at 0.25% less than the bank’s prime rate;
- \$100 million senior subordinated notes with semi-annual interest payments at 7¾%; and
- Commitment fee of 0.375% on the unused portion of our credit facilities.

**Credit Rating Agencies**

On a continuing basis, credit rating agencies such as Moody’s Investor Services (“Moody’s”) and Standard & Poor’s (“S&P”) evaluate our debt. On October 15, 2008, Moody’s placed us under credit review. Currently, our corporate family rating is B1 and our \$100 million 7¾% Notes are rated B3. The placement on credit review was prompted by the impact of the downturn in the economy on our performance, possible inadequate cushion under our financial covenants and refinancing risk associated with our revolving credit facility that matures in March 2009. On September 18, 2008, S&P rated us on credit watch with negative implications. S&P’s current rating on us is B+. The credit watch was based on uncertainty surrounding our ability to meet financial covenant step downs in the first quarter of 2009 and risks associated with our intermediate need for comprehensive refinancing.

**OFF BALANCE SHEET ARRANGEMENTS**

At September 30, 2008 and 2007, 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 constitute an off-balance sheet arrangement. 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.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### DERIVATIVE INSTRUMENTS

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

On April 8, 2005, we entered into an interest rate swap arrangement for the notional principal amount of \$30.0 million whereby we will pay a fixed interest rate of 4.99% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the three and nine months ended September 30, 2008, was increased by approximately \$0.2 million and \$0.4 million, as a result of the difference between the interest rates. As of September 30, 2008, we recorded a liability for the fair value of the interest rate swap of approximately \$1.4 million. This amount, net of income taxes of approximately \$0.6 million, is reflected in other comprehensive loss, as we have 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, we entered into a second interest rate swap arrangement for the notional principal amount of \$30.0 million whereby we will pay a fixed interest rate of 4.70% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the three and nine months ended September 30, 2008, was increased by approximately \$0.1 million and \$0.3 million, as a result of the difference between the interest rates. As of September 30, 2008, we recorded a liability for the fair value of the interest rate swap of approximately \$1.0 million. This amount, net of income taxes of approximately \$0.4 million, is reflected in other comprehensive loss, as we have 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, we entered into a third interest rate swap arrangement for the notional principal amount of \$30.0 million whereby we will pay a fixed interest rate of 4.53% as compared to LIBOR on a bank credit facility borrowing. Interest expense for the three and nine months ended September 30, 2008, was increased by approximately \$0.1 million and \$0.3 million, as a result of the difference between the interest rates. As of September 30, 2008, we recorded a liability for the fair value of the interest rate swap of approximately \$0.9 million. This amount, net of income taxes of approximately \$0.3 million, is reflected in other comprehensive loss, as we have 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 September 15, 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which is effective for fiscal years beginning after November 15, 2007. 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. In February 2008, the FASB deferred the adoption of SFAS No. 157 for one year as it applies to certain items, including assets and liabilities initially measured at fair value in a business combination, reporting units and certain assets and liabilities measured at fair value in connection with goodwill impairment tests in accordance with SFAS No. 142 and long-lived assets measured at fair value for impairment assessments under SFAS No. 144, *Accounting for the Impairment and Disposal of Long-Lived Assets*. The Company was required to adopt the provisions of SFAS No. 157 in 2008 as it relates to certain other items, including those within the scope of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, and financial and nonfinancial derivatives within the scope of SFAS No. 133. The adoption of SFAS No. 157 did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

SFAS No. 157 defines fair values as the price that would be received to acquire an asset or paid to transfer a liability in an orderly transaction between market participants, as of the measurement date. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants, as of the measurement

date. The standard establishes a hierarchy of inputs employed to determine fair value measurements, with three levels. Level 1 inputs are quoted prices in active markets for identical assets and liabilities, are considered to be the most reliable evidence of fair value, and should be used whenever available. Level 2 inputs are observable prices that are not quoted on active exchanges. Level 3 inputs are unobservable inputs employed for measuring the fair value of assets or liabilities.

The Company's financial liabilities reported at fair value in the accompanying condensed consolidated balance sheet, as of September 30, 2008, were as follows:

	As of September 30, 2008			
	<i>(Dollars in thousands)</i>			
	Level 1	Level 2	Level 3	Total
Interest rate swap agreements	—	3,290	—	3,290

#### Interest Rate Caps

On October 18, 2006, we 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 \$12,000 and \$9,000 was recognized during the three and nine months ended September 30, 2008, respectively, in comparison to \$200 and \$15,000 for the three and nine months ended September 30, 2007, respectively, related to the interest rate caps.

#### MARKET RISK

In addition to the interest rate swap agreements discussed above under "Derivative Instruments," borrowings under the credit facilities are subject to market risk exposure, specifically to changes in LIBOR and in the prime rate in the United States. As of September 30, 2008, we had borrowed \$233.7 million under our credit facilities and Swingline. As of September 30, 2008, we could borrow up to an additional \$36.7 million under the credit facilities. Amounts outstanding under the credit facilities bear interest at a rate based on, at Salem Holding's option, the bank's prime rate or LIBOR, in each case plus a spread. For purposes of determining the interest rate under our revolving credit facility, the prime rate spread ranges from 0.00% to 1.00%, and the LIBOR spread ranges from 1.00% to 2.00%. For both the term loan B facility and the term loan C facility, the prime rate spread ranges from 0.25% to 0.75%, and the LIBOR spread ranges from 1.25% to 1.75%. In each case, the spread is based on the Total Leverage Ratio on the date of determination. At September 30, 2008, the blended interest rate on amounts outstanding under the credit facilities was 5.31%. At September 30, 2008, a hypothetical 100 basis point increase in the prime rate or LIBOR, as applicable, would result in additional interest expense of \$1.4 million on an annualized basis.

In addition to the variable rate debt disclosed above, we have fixed rate debt with a carrying value of \$100.0 million relating to the outstanding 7¼% Notes as of September 30, 2008, with an aggregate fair value of \$82.0 million. We are exposed to changes in the fair value of these financial instruments based on changes in the market rate of interest on this debt. The ultimate value of these notes will be determined by actual market prices, as all of these notes are tradable. We estimate that a hypothetical 100 basis point increase in market interest rates would result in a decrease in the aggregate fair value of the notes to approximately \$80.6 million and a hypothetical 100 basis point decrease in market interest rates would result in the increase of the fair value of the notes to approximately \$83.5 million.

#### ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon such evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2008.

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

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

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

### ITEM 1A. RISK FACTORS

We have included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007, a description of certain risks and uncertainties that could affect our business, future performance or financial condition (the "Risk Factors") which are supplemented as provided below. The Risk Factors are hereby incorporated in Part II, Item 1A of this Form 10-Q.

#### *The Deterioration of the United States Economy Could Have Negative Consequences to Us.*

The current economic crisis in the United States has resulted in many companies reducing their advertising budgets, lack of consumer confidence and a tightening of the credit markets. This could have important consequences, including:

- a decline in advertising revenues as companies scale back their advertising spend;
- a decline in block programming revenues as our ministry partners face declining donations;
- an increase in uncollectible accounts;
- an increase in the possibility that we may not be able to refinance our capital structure as it matures beginning in March 2010 due to the lack of available credit; and
- an increase in interest expense in the near future due to repricing in any potential bank amendments or complete refinancing of our capital structure as the availability of credit has become challenging.

Investors should carefully consider the Risk Factors prior to making an investment decision with respect to our stock.

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

Not applicable.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

Not applicable.

### ITEM 6. EXHIBITS

## SIGNATURES

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

November 7, 2008

SALEM COMMUNICATIONS CORPORATION

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

November 7, 2008

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

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
10.05.02	Employment Agreement , effective as of September 15, 2008, between Salem Communications Holding Corporation and David A.R. Evans, filed as Exhibit 99.1 to the 8-K dated September 9, 2008.
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.



**EXHIBIT 23.3**

[Bond & Pecaro, Inc. letterhead]

October 17, 2008

VIA E-MAIL: [evanm@salem.cc](mailto:evanm@salem.cc)

Mr. Evan D. Masyr  
Vice President of Accounting and Corporate Controller  
Salem Communications Corp.  
4880 Santa Rosa Road #300  
Camarillo, CA 93012

Dear Mr. Masyr:

Bond & Pecaro, Inc. hereby grants permission to Salem Communications Corp. to use the Bond & Pecaro, Inc. name and data from our work product in public filings with the Securities and Exchange Commission.

I hope that this letter is responsive to your needs at this time. Please do not hesitate to let us know if you need anything additional.

Sincerely,

/s/ Timothy S. Pecaro

Timothy S. Pecaro

cc. Jim Brown

**EXHIBIT 31.1**

I, Edward G. Atsinger III, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Salem Communications Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2008

By: /s/ EDWARD G. ATSINGER III

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Edward G. Atsinger III  
Chief Executive Officer

**EXHIBIT 31.2**

I, Evan D. Masyr, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Salem Communications Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2008

By: /s/ EVAN D. MASYR

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Evan D. Masyr  
Senior Vice President and Chief Financial Officer

**EXHIBIT 32.1**  
**CERTIFICATION PURSUANT TO**  
**18 U.S.C. SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned hereby certifies, in his capacity as Chief Executive Officer of Salem Communications Corporation (the "Company"), for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that based on his knowledge:

- the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2008 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 7, 2008

By: /s/ EDWARD G. ATSINGER III

Edward G. Atsinger III  
Chief Executive Officer

**EXHIBIT 32.1**  
**CERTIFICATION PURSUANT TO**  
**18 U.S.C. SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned hereby certifies, in his capacity as Senior Vice President and Chief Financial Officer of Salem Communications Corporation (the "Company"), for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that based on his knowledge:

- the Quarterly report of the Company on Form 10-Q for the period ended September 30, 2008 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and
  
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 7, 2008

By: /s/ EVAN D. MASYSR

Evan D. Masysr  
Senior Vice President and Chief Financial Officer