SALEM COMMUNICATIONS CORP /DE/
Form 10-K
March 16, 2007

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

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

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Class A common stock, $0.01 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [ ] No [ X ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes [ ] No [ X]

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

Yes [X ]

No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ X ]

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

Large accelerated filer [ ]

Accelerated filer [X ]

Non-accelerated filer [ ]

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

Yes [ ] No [ X ]

As of June 30, 2006, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $60,734,622 based on the closing sale price as reported on the National Association of Securities Dealers Automated Quotation System National Market System.

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

| Class A | Outstanding at March 10, 2007 |
| --- | --- |
| Common Stock, $0.01 par value per share | 18,296,324 shares |

| Class B | Outstanding at March 10, 2007 |
| --- | --- |
| Common Stock, $0.01 par value per share | 5,553,696 shares |

**DOCUMENTS INCORPORATED BY REFERENCE**

| Document | Parts Into Which Incorporated |
| --- | --- |
| Proxy Statement for the Annual Meeting of Stockholders to be held June 6, 2007 | Part III, Items 10, 11, 12, 13 and 14 |

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**FORWARD-LOOKING STATEMENTS**

From time to time, in both written reports (such as this report) and oral statements, Salem Communications Corporation ( Salem or the company, including references to Salem by we, us and our ) makes forward-looking statements within the meaning of federal and state securities laws. Disclosures that use words such as the company believes, anticipates, expects, intends, will, may or plans and similar expressions are intended to identify forward-looking statements, as defined under the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect the company s current expectations and are based upon data available to the company at the time the statements are made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from expectations. These risks, as well as other risks and uncertainties, are detailed in Salem s reports on Forms 10-K, 10-Q and 8-K filed with 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 ).

All metropolitan statistical area ( MSA ) rank information used in this report, excluding information concerning The Commonwealth of Puerto Rico, is from the Fall 2006 Radio Market Survey Schedule & Population Rankings published by Arbitron. According to the Radio Market Survey, the population estimates used were based upon 2000 U.S. Bureau Census estimates updated and projected to January 1, 2007 by Claritas, Inc.



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# PART I

## ITEM 1. BUSINESS.

## GENERAL

We believe that we are the largest commercial U.S. radio broadcasting company, measured by number of stations and audience coverage, providing programming targeted at audiences interested in Christian and family-themed radio programming. Our core business is the ownership and operation of radio stations in large metropolitan markets. Upon completion of all announced transactions, we will own a national portfolio of 97 radio stations in 36 markets, including 61 stations in 23 of the top 25 markets, which consists of 30 FM stations and 67 AM stations. We are one of only four commercial radio broadcasters with radio stations in all of the top 10 markets. We are the sixth largest operator measured by number of stations overall and the third largest operator measured by number of stations in the top 25 markets.

Our radio business is focused on the clustering of three strategic formats: Christian Teaching and Talk, Contemporary Christian Music and conservative News Talk. We also own and operate Salem Radio Network® ( SRN ), a national radio network that syndicates music, news and talk to approximately 2,000 affiliated radio stations, in addition to our owned and operated stations. Salem Radio Representatives® ( SRR ) is a national radio advertising sales firm with offices in 13 U.S. cities. Additionally, we own Salem Web Network™ (“SWN”), a provider of online Christian content and streaming, Townhall.com, a provider of conservative content on-line, and Salem Publishing™, a leading publisher of Christian magazines and Xulon Press, a digital publisher of books targeting the Christian audience.

### Business Strategy

Our principal business strategy is to expand and improve our national radio platform in order to deliver compelling content to audiences interested in Christian and family-themed programs and conservative news talk. Our national presence gives advertisers a station platform that is a unique and a powerful way to reach a Christian audience. We program 45 of our stations with our Christian Teaching and Talk format, which is talk programming with Christian and family themes. A key programming strategy on our Christian Teaching and Talk radio stations is to sell blocks of time to a variety of charitable organizations that create compelling radio programs. We also program 31 News Talk and 13 Contemporary Christian Music stations. SRN supports our strategy by allowing us to reach listeners in markets where we do not own or operate stations.

Both our chief executive officer and our chairman are career radio broadcasters who have owned and operated radio stations for more than 40 years.

### Acquisition Strategy

Since our initial public offering in July 1999, we have grown from 46 radio stations to 97 stations located in 36 radio markets. Our principal acquisition strategy is focused on acquiring stations in markets that have strong signals and will deliver an appropriate return on investment. Because of our unique programming strategy serving Christian and family-themed audiences, we usually reformat each acquired station, which means we need to market and promote the new format, develop listenership and cultivate a customer base to grow revenues. It can take five to six years of development for an acquired radio station to reach maturity. Over the long-term, this strategy gives stations a competitive advantage and allows us to serve our large and loyal market segment.

We strive to build clusters of radio stations in each of our markets with each format targeting different demographic segments of the audience interested in Christian and family-themed programming. There are several potential benefits that result from operating multiple radio stations in the same market. First, this clustering and programming segmentation strategy allows us to achieve greater penetration into each segment of our target market and collectively our stations afford our clients a larger percentage of advertising time in that market. We then are able to offer advertisers multiple audiences and to bundle the radio stations for advertising sales purposes when advantageous. Second, we realize cost and operating efficiencies by consolidating sales, technical and administrative support and promotional functions where possible. Finally, the purchase of additional radio stations in an existing market allows us to leverage our market expertise to better serve our advertisers and our listeners through traditional and emerging media.

In addition to our radio station acquisitions, we look for Christian and conservative content, Internet and publishing opportunities that we can effectively integrate into our existing operations in a complementary manner.

**Programming Strategy**

Through the strength of our Christian Teaching and Talk format, the influence of our News Talk format and the growing popularity of our Contemporary Christian Music format, we believe we remain well-positioned to improve upon our leadership position in Christian and family-themed radio.

*Christian Teaching and Talk.* Christian Teaching and Talk is our foundational format. Through this format, a listener can hear Bible teaching and sermons, as well as gain answers to questions relating to daily life, from raising children to religious legal rights in education and the workplace. This format serves as both a learning resource and as a personal support for listeners nationwide. In response to the daily programming of our block programming partners, listeners call and write into these programs to ask questions, get more materials on a subject and receive study guides based on what they have learned on the radio.

*Block Programming. O*ur national station platform and focused programming strategy provides us with the ability to consistently offer block programmers on our Christian Teaching and Talk stations both scale and targeting efficiencies. Historically, more than 90 percent of our block programming partners renewed their respective relationships with us. As a result, our block programming business tends to be recession resilient and provides a steady and consistent stream of revenue and cash flow.

*News Talk.* News talk programming is the second most popular radio format in the country, based both on listenership and number of radio stations. Our research has shown that our News Talk format is highly complementary to our core format of Christian Teaching and Talk. As programmed by Salem, both formats express conservative views and family values. Our News Talk format also provides us with the opportunity to leverage syndicated talk programming produced by our network, SRN. Our nationally syndicated programs are distributed through approximately 2,000 affiliates.

*The FISH® - Contemporary Christian Music.* Through our Contemporary Christian Music ( CCM ) format, called The FISH® in most markets, we are able to bring listeners the words of inspirational recording artists, set to upbeat contemporary music. Our music format is branded Safe for the Whole Family® , with sounds that everyone enjoys and lyrics that parents appreciate. The CCM genre continues to be popular and is the sixth largest genre in terms of album sales. We believe this listener base has been underserved in terms of radio coverage, especially in the larger markets.

*XM Satellite Radio.* As America's most popular satellite radio service, XM reaches 7.6 million subscribers from coast to coast. Our satellite radio station, XM 170, is the exclusive Christian Teaching and Talk channel on XM, reaching the entire nation 24 hours a day, seven days a week.

**Audience Growth**

We grow our audience by providing high quality, compelling content on our radio stations and in syndication that is tested and fine-tuned to appeal to our listeners in each of our strategic formats. We work to maximize audience share and then convert these audience share ratings to advertising revenue and control operating costs. We rely on a combination of research, marketing, targeted promotions and live events that create visibility and brand awareness for our stations in their local markets.

**Station Development**

Due to our acquisition strategy and some station format changes, approximately half of our radio stations are in a start-up or early development stage. Less mature stations generally grow their revenue and cash flow at a faster rate than mature stations.  Our strategy is to drive start-up and development stage stations to maturity as rapidly and as effectively as possible.   In addition, we focus on improving same-station revenue and station operating income at our mature stations. The start-up to maturity process in most cases is a span of five to six years, beginning with a period of start-up losses moving to breakeven and then growing profitability. As our start-up and development stage stations mature, significant revenue and cash flow growth is realized. Operating income margins typically improve as radio stations mature due to the fact that many costs are fixed or grow at or around the rate of inflation while revenues of the station tend to grow at a faster rate.



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**Technical Improvements**

A key focus for us is looking for ways to improve a radio station s broadcast signal so that it can reach as many listeners as possible, both during the day and at night. We have completed a number of enhancements that will improve the coverage of a number of signals, including several in the top 25 markets. In early 2006, Salem launched KTRO-FM, a new station in Portland, Oregon. Additionally, during 2006 Salem completed a tower upgrade project for WLQV-AM in Detroit, Michigan, and relocated our tower for KKOL-AM in Seattle, Washington.

**Radio Advertising Sales**

We have assembled an effective, highly-trained sales staff responsible for converting audience share into revenue. We operate with a focused, sales-oriented culture that rewards selling efforts through a commission and bonus compensation structure. We hire and deploy teams of sales professionals for each of our stations or station clusters, and we provide these teams with the resources necessary to compete effectively in the markets in which we operate. We utilize various sales strategies to sell and market our stations as stand-alones, in combination with other stations within a given market and across markets, where appropriate.

**Marketing Platform to National Advertisers**

We have created a national platform of radio stations that reaches more than four million listeners weekly. National companies find advertising on multiple radio stations to be an efficient and cost-effective way to reach this target audience. Through SRR, we bundle and sell this national platform of radio stations to national advertisers, thereby enhancing our revenue generating opportunities, expanding our base of advertisers, creating greater demand for our advertising time inventory, and making our sales effort more efficient.

**Significant Community Involvement**

We believe our active involvement and significant relationships in the Christian community provide a competitive advantage in targeting Christian audiences. Our proactive involvement in the Christian community in each of our markets significantly improves the marketability of our radio broadcast time to advertisers who are targeting such communities. We believe that a radio station s image should reflect the lifestyle and viewpoints of the target demographic group it serves. We regularly partner with organizations that serve the Christian and family-themed audience and sponsor and support events important to this group. These events include listener rallies, pastor appreciation events and concerts like *Fishfest*® and *Celebrate Freedom*™. These events connect us with our listeners and enable us to create enhanced awareness and name recognition in our markets. Involvement leads to increased effectiveness in developing and improving our programming formats, leading to greater listenership and higher ratings over the long-term.

**Corporate Structure**

The management of our operations is decentralized. Our operations vice presidents, some of whom are also station general managers, oversee several markets on a regional basis. Our operations vice presidents are experienced radio broadcasters with expertise in sales, programming, marketing and production. We anticipate relying on this strategy of decentralization and encourage operations vice presidents to apply innovative techniques to the operations they oversee which, if successful, can be implemented at our other stations.

Our corporate headquarters personnel oversee the placement and rate negotiation for all national block programs. Centralized oversight of this component of our revenue is necessary because our key block program customers purchase time in many of our markets. Corporate headquarters personnel also are responsible for centralized accounting and finance functions, information technology, human resources, legal, engineering, real estate, strategic direction and other support functions designed to provide resources to local management.

**CORPORATE INFORMATION**



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We maintain a website at 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 ).

Salem Communications Corporation was formed in 1986 as a California corporation and was reincorporated in Delaware in 1999. Salem Communications Holding Corporation ( Salem Holding ) was formed as a wholly-owned subsidiary of Salem Communications Corporation in May 2000. In May 2000, Salem Communications Corporation formed an additional wholly-owned subsidiary, Salem Communications Acquisition Corporation ( AcquisitionCo ), which has since acquired nine radio stations through its wholly-owned subsidiary, SCA License Corporation. In August 2000, Salem Communications Corporation assigned substantially all of its assets and liabilities (other than stock of Salem Holding and AcquisitionCo) to Salem Holding.

In June 2001, Salem Holding effected a dividend to Salem Communications Corporation of Salem Holding s publishing and Internet businesses. This transaction was effected as a dividend of the capital stock and membership interests, respectively, of Salem Holding s wholly-owned subsidiaries CCM Communications, Inc. ( CCM ) and OnePlace, LLC ( OnePlace ). As a result, CCM and OnePlace became direct subsidiaries of Salem Communications Corporation. Subsequently, the membership interests of OnePlace were contributed to SCA License Corporation, and OnePlace became an indirect subsidiary of Salem. Salem Communications Corporation and all of its subsidiaries (other than Salem Holding) are guarantors of the borrowings under Salem Holding s credit facility and Salem Holding s $100.0 million 7¾% senior subordinated notes due 2010 ( 7¾% Notes ).

**DEVELOPMENT OF THE BUSINESS**

In 2006, we completed the purchase of selected assets of the following radio stations:

| Date | Market | Station | MSA Rank (1) | | Purchase Price |
|---|---|---|---|---|---|
| | | | | | ***(Dollars in thousands)*** |
| January 23, 2006 | Orlando, FL | WTLN-AM | 33 | $ | 5,497 |
| January 23, 2006 | Orlando, FL | WHIM-AM | 33 | | 4,503 |
| February 3, 2006 | Orlando, FL | WORL-AM (2) | 33 | | 3,998 |
| February 10, 2006 | Detroit, MI | WLQV-AM (3) | 10 | | 8,813 |
| May 12, 2006 | Sacramento, CA | KKFS-FM (4) | 26 | | 21,835 |
| October 1, 2006 | Honolulu, HI | KORL-AM (5) | 63 | | 1,546 |
| | | | | $ | 46,192 |

(1)

MSA means metropolitan statistical area per the fall 2006 Radio Market Survey Schedule and Population Rankings published by Arbitron, excluding The Commonwealth of Puerto Rico.

(2)

Selected assets of radio station WORL-AM, Orlando, Florida were acquired in exchange for radio station KNIT-AM, Dallas, Texas. The exchange was accounted for under Statement of Financial Accounting Standards ( SFAS ) No. 153, Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29, adopted as of January 1, 2006, resulting in a pre-tax gain on the exchange of $3.5 million.

(3)

Selected assets of radio station WLQV-AM, Detroit, Michigan, were acquired in exchange for radio stations WTSJ-AM, Cincinnati, Ohio, and WBOB-AM, Cincinnati, Ohio and $6.7 million in cash. The exchange was accounted for under SFAS No. 153, and resulted in a pre-tax gain on the exchange of $0.7 million.

(4)

Selected assets of radio station KKFS-FM, Sacramento, California was acquired in exchange for selected assets of radio station KLMG-FM, Sacramento, California. The exchange was accounted for under SFAS No. 153 and resulted in a pre-tax gain on the exchange of $14.6 million

(5)

Selected assets of radio station KORL-AM, Honolulu, Hawaii were acquired in exchange for selected assets of radio station KHCM-AM, Honolulu, Hawaii, and $1.0 million in cash. The Company retained the call letters of the station. The exchange was accounted for under SFAS No. 153 and resulted in a pre-tax loss on the exchange of $0.04 million.

In 2006, we completed the purchase of the following non-broadcast entities:

| Date | Entity | Purchase Price *(Dollars in thousands)* | |
|---|---|---|---|
| January 1, 2006 | The Singing News | $ | 4,400 |
| February 13, 2006 | CrossDaily.com | | 2,250 |
| April 28, 2006 | Townhall.com | | 4,788 |
| June 1, 2006 | Preaching Magazine | | 250 |
| June 1, 2006 | Xulon Press | | 1,500 |
| | | $ | 13,188 |

**RADIO STATIONS**

Upon the close of all announced transactions, the company will own and/or operate a national portfolio of 97 radio stations in 36 markets, consisting of 30 FM stations and 67 AM stations. The following table sets forth information about each of Salem s stations, in order of market size:

| Market (1) | MSA Rank (2) | Station Call Letters | Year Acquired | Format |
|---|---|---|---|---|
| New York, NY | 1, 17 (3) | WMCA-AM | 1989 | Christian Teaching and Talk |
| | | WWDJ-AM | 1994 | Christian Teaching and Talk |
| Los Angeles, CA | 2 | KKLA-FM | 1985 | Christian Teaching and Talk |
| | | KRLA-AM | 1998 | News Talk |
| | | KFSH-FM | 2000 | Contemporary Christian Music |
| | | KXMX-AM | 2000 | Ethnic Brokered Programming |
| Chicago, IL | 3 | WYLL-AM | 2001 | Christian Teaching and Talk |
| | | WIND-AM | 2005 | News Talk |
| San Francisco, CA | 4, 34 (4) | KFAX-AM | 1984 | Christian Teaching and Talk |
| | | KNTS-AM | 2001 | News Talk |
| Dallas-Fort Worth, TX | 5 | KLTY-FM | 1996 | Contemporary Christian Music |
| | | KWRD-FM (5) | 2000 | Christian Teaching and Talk |
| | | KSKY-AM | 2000 | News Talk |
| Houston-Galveston, TX | 6 | KNTH-AM | 1995 | News Talk |
| | | KTEK-AM | 1998 | Christian Teaching and Talk |
| | | KKHT-FM | 2005 | Christian Teaching and Talk |
| Philadelphia, PA | 7 | WFIL-AM | 1993 | Christian Teaching and Talk |
| | | WNTP-AM | 1994 | News Talk |
| Washington, D.C. | 8 | WAVA-FM | 1992 | Christian Teaching and Talk |
| | | WAVA-AM | 2000 | Christian Teaching and Talk |
| Atlanta, GA | 9 | WNIV-AM | 2000 | Christian Teaching and Talk |

| | | | | |
|---|---|---|---|---|
| | | WLTA-AM | 2000 | Christian Teaching and Talk |
| | | WAFS-AM (6) | 2000 | Ethnic Brokered Programming |
| | | WFSH-FM | 2000 | Contemporary Christian Music |
| | | WGKA-AM | 2004 | News Talk |
| Detroit, MI | 10 | WDTK-AM | 2004 | News Talk |
| | | WLQV-AM | 2006 | Christian Teaching and Talk |
| Boston, MA | 11 | WEZE-AM | 1997 | Christian Teaching and Talk |
| | | WROL-AM | 2001 | Christian Teaching and Talk |
| | | WTTT-AM | 2003 | News Talk |
| Miami, FL | 12 | WKAT-AM | 2004 | Christian Teaching and Talk |
| Seattle-Tacoma, WA | 13 | KGNW-AM | 1986 | Christian Teaching and Talk |
| | | KLFE-AM | 1994 | Christian Teaching and Talk |

**RADIO STATIONS, CONT.**

| Market (1) | MSA Rank (2) | Station Call Letters | Year Acquired | Format |
|---|---|---|---|---|
| | | KDOW-AM (formerly KTFH-AM) (7) | 1997 | Ethnic Brokered Programming |
| | | KKMO-AM | 1998 | Spanish |
| | | KKOL-AM | 1999 | News Talk |
| Phoenix, AZ | 14 | KKNT-AM | 1996 | News Talk |
| | | KPXQ-AM | 1999 | Christian Teaching and Talk |
| Minneapolis-St. Paul, MN | 15 | KKMS-AM | 1996 | Christian Teaching and Talk |
| | | KYCR-AM | 1998 | News Talk |
| | | WWTC-AM | 2001 | News Talk |
| San Diego, CA | 16 | KPRZ-AM | 1987 | Christian Teaching and Talk |
| | | KCBQ-AM | 2000 | News Talk |
| Tampa, FL | 18 | WTWD-AM (8) | 2000 | Christian Teaching and Talk |
| | | WTBN-AM (8) | 2001 | Christian Teaching and Talk |
| | | WGUL-AM | 2005 | News Talk |
| Denver-Boulder, CO | 21 | KRKS-FM | 1993 | Christian Teaching and Talk |
| | | KRKS-AM | 1994 | Christian Teaching and Talk |
| | | KNUS-AM | 1996 | News Talk |
| | | KBJD-AM (9) | 1999 | News Talk |
| Portland, OR | 22 | KPDQ-FM | 1986 | Christian Teaching and Talk |
| | | KPDQ-AM | 1986 | Christian Teaching and Talk |
| | | KFIS-FM | 2002 | Contemporary Christian Music |
| | | KTRO-FM (formerly KAST-FM) | 2005 | News Talk |
| | | KKSN-AM (10) | 2007 | News Talk |

| | | | | |
|---|---|---|---|---|
| Pittsburgh, PA | 23 | WORD-FM | 1993 | Christian Teaching and Talk |
| | | WPIT-AM | 1993 | Christian Teaching and Talk |
| Riverside-San Bernardino, CA | 24 | KTIE-AM | 2001 | News Talk |
| Cleveland, OH | 25 | WHKW-AM | 2000 | Christian Teaching and Talk |
| | | WFHM-FM | 2001 | Contemporary Christian Music |
| | | WHK-AM | 2005 | News Talk |
| Sacramento, CA | 26 | KFIA-AM | 1995 | Christian Teaching and Talk |
| | | KTKZ-AM | 1997 | News Talk |
| | | KTKZ-FM | 2002 | News Talk |
| | | KKFS-FM | 2006 | Contemporary Christian Music |
| San Antonio, TX | 28 | KSLR-AM | 1994 | Christian Teaching and Talk |
| | | KLUP-AM | 2000 | News Talk |
| Orlando, FL | 33 | WORL-AM | 2006 | News Talk |
| | | WTLN-AM | 2006 | Christian Teaching and Talk |
| | | WHIM-AM | 2006 | Christian Teaching and Talk |
| Milwaukee-Racine, WI | 35 | WRRD-AM | 2001 | Christian Teaching and Talk |
| | | WFZH-FM | 2001 | Contemporary Christian Music |
| Columbus, OH | 36 | WRFD-AM | 1987 | Christian Teaching and Talk |
| Nashville, TN | 43 | WBOZ-FM | 2000 | Southern Gospel |
| | | WFFH-FM (11) | 2002 | Contemporary Christian Music |
| | | WFFI-FM (11) | 2002 | Contemporary Christian Music |
| Louisville, KY | 53 | WFIA-FM | 1999 | Christian Teaching and Talk |
| | | WRVI-FM | 1999 | Contemporary Christian Music |
| | | WGTK-AM | 2000 | News Talk |
| | | WFIA-AM | 2001 | Christian Teaching and Talk |

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| Market (1) | MSA Rank (2) | Station Call Letters | Year Acquired | Format |
|---|---|---|---|---|
| Honolulu, HI | 63 | KHNR-AM | 2000 | News Talk |
| | | KAIM-FM | 2000 | Contemporary Christian Music |
| | | KGU-AM | 2000 | Christian Teaching and Talk |
| | | KHCM-AM (formerly KORL-AM) | 2006 | Country Music |
| | | KHNR-FM | 2004 | News Talk |
| | | KHUI-FM | 2004 | Adult Standards |
| | | KGMZ-FM | 2005 | Adult Nostalgia |
| Omaha, NE | 71 | KGBI-FM | 2005 | Contemporary Christian Music |
| | | KOTK-AM (formerly KHLP-AM) | 2005 | News Talk |
| | | KCRO-AM | 2005 | Christian Teaching and Talk |
| Sarasota-Bradenton, FL | 72 | WLSS-AM | 2005 | News Talk |
| Colorado Springs, CO | 96 | KGFT-FM | 1996 | Christian Teaching and Talk |
| | | KBIQ-FM | 1996 | Contemporary Christian Music |
| | | KZNT-AM | 2003 | News Talk |
| Youngstown-Warren, OH | 116 | WHKZ-AM | 2001 | Christian Teaching and Talk |
| Oxnard-Ventura, CA | 119 | KDAR-FM | 1974 | Christian Teaching and Talk |
| Tyler-Longview, TX | 147 | KPXI-FM (5) | 2000 | Christian Teaching and Talk |

(1) Actual city of license may differ from metropolitan market served.

(2) MSA means metropolitan statistical area per the fall 2006 Radio Market Survey Schedule and Population Rankings published by Arbitron, excluding the Commonwealth of Puerto Rico.

(3) This market includes the Nassau-Suffolk, NY Metro market which independently has a MSA rank of 17.

(4) This market includes the San Jose, CA market which independently has a MSA rank of 34.

(5) KPXI-FM is simulcast with KWRD-FM, Dallas-Fort Worth, TX.

(6) WAFS-AM is currently being programmed by Radio Planeta X, Inc. pursuant to a local marketing agreement that can be terminated by Salem on 30 days notice.

(7) KDOW-AM is an expanded band AM station. Under current Federal Communications Commission ( FCC ) rules, we will be required to surrender to the FCC the license for either KDOW-AM or KLFE-AM on July 14, 2009.

(8) WTBN-AM is simulcast with WTWD-AM, Tampa, FL.

(9) KBJD-AM is an expanded band AM station. Under current FCC rules, we must request special temporary authority (STA) to operate the station for periods of approximately six months. An STA request was filed on February 12, 2007 and will be requested every six months thereafter pursuant to the FCC requirements.

(10) KKSN-AM is being operated under a Time Brokerage Agreement with Entercom Portland License, LLC as of February 1, 2007.

(11) WFFH-FM is simulcast with WFFI-FM, Nashville, TN.

*PROGRAM REVENUE.* For the year ended December 31, 2006 we derived 19.9% and 14.9% of our net broadcasting revenue, or $41.5 million and $31.0 million, respectively, from the sale of nationally syndicated and local block program time. We derive nationally syndicated program revenue from a programming customer base consisting primarily of geographically diverse, well-established non-profit religious and educational organizations that purchase time on stations in a large number of markets in the United States. Nationally syndicated program producers typically purchase 13, 26 or 52 minute blocks on a Monday through Friday basis and may offer supplemental programming for weekend release. We obtain local program revenue from community organizations and churches that typically purchase time primarily for weekend release and from local speakers who purchase daily releases. We believe our management has been successful in assisting quality local programs expand into national syndication.

*ADVERTISING REVENUE.* For the year ended December 31, 2006, we derived 43.9% of our net broadcasting revenue, or $91.5 million from the sale of local spot advertising and 8.4% of our net broadcasting revenue, or $17.5 million from the sale of national spot advertising.

**SALEM RADIO NETWORK® AND SALEM RADIO REPRESENTATIVES ™**

In 1993, we established Salem Radio Network, ("SRN"). Establishment of SRN was a part of our overall business strategy to develop a national network of affiliated radio stations anchored by our owned and operated radio stations in major markets. SRN, which is headquartered in Dallas, Texas, develops, produces and syndicates a broad range of programming specifically targeted to Christian and family-themed talk and music stations as well as general market News Talk stations. Currently, we have rights to several full-time satellite channels to deliver SRN programs to affiliates via satellite.

SRN has approximately 2,000 affiliate stations, including our owned and operated stations, which broadcast one or more of the offered programming options. These programming options feature talk shows, news and music. The principal source of network revenue is from the sale of advertising time.

We established Salem Radio Representatives ( SRR ) in 1992 as a sales representation company specializing in placing national advertising on religious format radio stations. SRN and our radio stations each have relationships with SRR for the sale of available SRN spot advertising. SRR receives a commission on all SRN sales. SRR also contracts with individual radio stations to sell air time to national advertisers desiring to include selected company stations in national buys covering multiple markets. We established Vista Radio Representatives ( VRR ) in 2005, a sales representation company specializing in placing national advertising on non-religious format radio stations.

We recognize our advertising and commission revenue from radio stations as the spots are aired. SRN s net revenue, including commission revenue for SRR, for the year ended December 31, 2006 was $14.8 million.

**NON-BROADCAST MEDIA**

*Salem Web Network™ and Townhall™.com.* Our online strategy centers on creating the premiere Internet platform serving the audience interested in Christian and conservative content. Leveraging our engaged and loyal radio listener base, SWN s content, both in text and audio, can be accessed through our national portals which include Townhall.com, OnePlace.com, Crosswalk.com, Christianity.com and through our 95 radio station websites, which provide local content of interest to our local radio station listeners. In 2006 we acquired CrossDaily.com and Townhall.com. These recent acquisitions enhance our web leadership as a provider and distributor of Christian and family-values content and services for our target audience. SWN generates more than one billion page views annually and has more than four million unique visitors each month.

*Salem Publishing™.* Our leadership in the distribution of Christian content also extends into print through Salem Publishing, a magazine publisher serving the Christian audience and the Christian music industry and Xulon Press, a provider of print-on-demand publishing services targeted to the Christian audience. Last year, we published more than two million units. Our flagship publication, CCM Magazine®, has covered the contemporary Christian music industry for more than 25 years, playing an important role in the growth of contemporary Christian music. Salem Publishing™ is well positioned to grow with the addition of its other magazines: Homecoming® The Magazine, YouthWorker Journal™, The Singing News, FaithTalk Magazine, Preaching and CrossWalk.com® Magazine. In 2006, we acquired two target segment-leading magazines, The Singing News magazine and Preaching magazine, and their respective web sites. In 2006, we also purchased the Xulon Press.



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**COMPETITION**

*RADIO.* The radio broadcasting industry, including the segment of this industry that focuses on Christian and family themes, is a highly competitive business. The financial success of each of our radio stations that focuses on Christian Teaching and Talk is dependent, to a significant degree, upon its ability to generate revenue from the sale of block program time to national and local religious and educational organizations. We compete for this program revenue with a number of different commercial and noncommercial radio station licensees. While no commercial group owner in the United States specializing in Christian and family- themed programming approaches Salem in size of potential listening audience and presence in major markets, other religious radio stations exist and enjoy varying degrees of prominence and success in all markets.

We also compete for revenue in the spot advertising market with other commercial religious format and general format radio station licensees. We compete in the spot advertising market with non-broadcast media as well, including broadcast television, cable television, newspapers, magazines, direct mail, Internet and billboard advertising, some of which may be controlled by horizontally-integrated companies.

Competition may also come from new media technologies and services that are being developed or introduced. These include delivery of audio programming by cable television and satellite systems, digital audio radio services, mobile telephony, personal communications services and the service of low powered, limited coverage FM radio stations authorized by the FCC. Digital audio broadcasting will deliver multi-format digital radio services by satellite to national and regional audiences. The quality of programming delivered by digital audio broadcasting would be equivalent to compact disc. The delivery of live and stored audio programming through the Internet has also created new competition. In addition, commencement of satellite delivered digital audio radio services, which delivers multiple audio programming formats to local and national audiences, has created competition. We have attempted to address these existing and potential competitive threats through a more active strategy to acquire and integrate new electronic communications formats including Internet acquisitions made by SWN and our exclusive arrangement to provide Christian and family-themed talk and music formats on one of the two FCC licensees of satellite digital audio radio services.

*NETWORK.* Salem Radio Network® ( SRN ) competes with other commercial radio networks that offer news and talk programming to religious and general format stations and two noncommercial networks that offer Christian music formats. SRN also competes with other radio networks for the services of talk show personalities.

*NON-BROADCAST MEDIA.* Our magazines compete for readers and advertisers with other publications that follow the Christian music industry and publications that address themes of interest to church leadership and the Christian audience. Xulon Press competes for authors with other on-demand publishers and other Christian book publishers. Our Internet business competes for visitors and advertisers with other companies that deliver on-line audio programming and Christian and conservative Internet content as well as providers of general market Internet sites.

**SEGMENTS**

The Company has one reportable operating segment - radio broadcasting. The remaining non-reportable segments consist of SWN and Salem Publishing, which do not meet the reportable segment quantitative thresholds and accordingly are aggregated as non-broadcast media. The radio broadcasting segment also operates various radio networks. The Company has presented its segment information in Note 12 of the Notes to the Consolidated Financial Statements, Item 8 of Part II of this report, incorporated by reference.

**EMPLOYEES**

On February 28, 2007, Salem employed 1,171 full-time and 375 part-time employees. None of Salem s employees are covered by collective bargaining agreements, and we consider our relations with our employees to be good.

## ITEM 1A. RISK FACTORS

## CERTAIN FACTORS AFFECTING SALEM

***We may choose not to pursue potentially more profitable business opportunities outside of our Christian, conservative news talk and family-themed formats, or not to broadcast programming that violates our programming standards, either of which may have a material adverse effect on our business.***

We are fundamentally committed to broadcasting Internet and publishing formats and programming emphasizing Christian, conservative news talk and family themes. We may choose not to switch to other formats or pursue potentially more profitable business opportunities in response to changing audience preferences. We do not intend to pursue business opportunities or air programming that would conflict with our core commitment to Christian and family themes formats or that would violate our programming standards, even if such opportunities or programming would be more profitable. Our decision not to pursue other formats or air programming inconsistent with our programming standards might result in lower operating revenues and profits than we might otherwise achieve.

***We Must Respond To the Rapid Changes in Technology, Services and Standards of Our Industry In Order To Remain Competitive***

The radio broadcasting industries are subject to rapid technological change, evolving industry standards and the emergence of competition from new media technologies and services. We cannot assure you that we will have the resources to acquire new technologies or to introduce new services that could compete with these new technologies. Various new media technologies and services are being developed or introduced, including:

- satellite-delivered digital audio radio service, which has resulted in the introduction of new subscriber-based satellite radio services with numerous niche formats;
- audio programming by cable systems, direct-broadcast satellite systems, personal communications systems, content available over the Internet and other digital audio broadcast formats;
- in-band on-channel digital radio, which provides multi-channel, multi-format digital radio services in the same bandwidth currently occupied by traditional AM and FM radio services;
- low-power FM radio, which could result in additional FM radio broadcast outlets;
- mobile telephony; and
- iPod or similar music players.

We currently program one channel on XM Satellite Radio. We also offer pod-casts and downloads of portions of our programming, however, we cannot assure you that this arrangement will continue, will be successful or enable us to adapt effectively to these new media technologies. We cannot predict the effect, if any, that competition arising from new technologies or regulatory change may have on the radio broadcasting industry or on our financial condition and results of operations.

***The Accounting Treatment of Goodwill and FCC Licenses Could Cause Future Losses Due To Asset Impairment***

Under Statement of Financial Accounting Standards ( SFAS ) 142 Goodwill and Other Intangible Assets, goodwill and some indefinite-lived intangibles, including FCC licenses, are not amortized into results of operations, but instead are tested for impairment at least annually, with impairment being measured as the excess of the carrying value of the goodwill or intangible over its fair value. In addition, goodwill and intangible assets are tested more often for impairment as circumstances warrant. Intangible assets that have finite useful lives continue to be amortized over their useful lives and are measured for impairment in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Any impairment losses under SFAS No. 142 or SFAS No. 144 will be recorded as operating expenses. Our future impairment reviews could result in asset write-downs.

***We May Be Unable To Integrate the Operations and Management of Acquired Stations or Businesses, Which Could Have a Material Adverse Effect on Our Business and Operating Results***

Since January 1, 2006, we have acquired selected assets of six radio stations, two Internet businesses and three publishing businesses, and we expect to make acquisitions of other stations and related non-broadcast businesses in the future. We cannot assure you that we will be able to successfully integrate the operations or management of acquired stations and businesses and realize anticipated revenue synergies, or the operations or management of stations and businesses that might be acquired in the future. Continued acquisitions of stations will require us to manage a larger and likely more geographically diverse radio station portfolio than historically has been the case. Our inability to integrate and manage newly acquired stations or businesses successfully could have a material adverse effect on our business and operating results.

***If We Are Unable To Implement Our Cluster Strategy, We May Not Realize Anticipated Operating Efficiencies***

As part of our operating strategy, we attempt to realize efficiencies in operating costs and cross-selling of advertising by clustering the operations of two or more radio stations in a single market. However, there can be no assurance that this operating strategy will be successful. Furthermore, we cannot assure you that the clustering of radio stations in one market will not result in downward pressure on advertising rates at one or more of the existing or new radio stations within the cluster. There can be no assurance that any of our stations will be able to maintain or increase its current listening audiences and operating revenue in circumstances where we implement our clustering strategy.

Additionally, FCC rules and policies allow a broadcaster to own a number of radio stations in a given market and permit, within limits, joint arrangements with other stations in a market relating to programming, advertising sales and station operations. We believe that radio stations that elect to take advantage of these clustering opportunities may, in certain circumstances, have lower operating costs and may be able to offer advertisers more attractive rates and services. The future development of our business in new markets, as well as the maintenance of our business growth in those markets in which we do not currently have radio station clusters, may be negatively impacted by competitors who are taking advantage of these clustering opportunities by operating multiple radio stations within markets.

***The restrictions on ownership of multiple stations in each market may prevent us from implementing our cluster strategy.***

As part of our growth strategy, we seek to acquire additional radio stations in markets in which we already have existing stations. However, our ability to acquire, operate and integrate any such future acquisitions as part of a cluster is limited by antitrust laws, the Federal Communications Act of 1934 (the Communications Act ), FCC regulations and other applicable laws and regulations. Changes to any of these laws or regulations may affect our ability to acquire additional stations in radio markets where we already own one or more radio stations.

In 1996, Congress passed legislation that requires the FCC to periodically conduct reviews of is regulations, including ones that govern the maximum number of radio stations an entity may own or have joint arrangements with relating to programming, advertising sales and station operations (the Ownership Limits ). The FCC has adopted radio multiple ownership rules that depend upon the total number of radio stations located in the market in determining the applicable Ownership Limits. In 2003, the FCC modified its definition of the term market and its method of determining the number of radio stations located in a market. Specifically, in larger markets the FCC replaced its signal contour method of defining a market and determining the number of radio stations located in the market with the use of geographic markets delineated by The Arbitron Company ( Arbitron ), which is a commercial ratings service. For smaller radio markets for which Arbitron has not delineated a geographic market, the signal contour method continues to be the method of defining the market and determining the number of radio stations in the market. The methods the FCC uses to define markets affect the number of radio stations an entity may own or have joint arrangements with relating to programming, advertising sales and station operations in areas adjacent to a delineated Arbitron market. In 2006, the FCC opened a new phase of rulemaking concerning its broadcast ownership rules. The FCC is currently seeking public comments on the existing rules, including arguments and factual data on their impact on competition, localism, and diversity. The FCC has held, and is planning to hold more, public meetings around the country on the issue of media ownership rules, including regulations affecting the Ownership Limits, and how to define the term market. The FCC has also commissioned a series of research studies in these issues. In addition, interest has been expressed by members of Congress to reduce the Ownership Limits.

We cannot predict the impact of possible modifications to the FCC s local radio multiple ownership rules on our business operations. Likewise, we cannot predict whether there will be a change in the antitrust laws, Communications Act or other laws governing the ownership or operation of radio stations, or whether the FCC, Department of Justice ( DOJ ) or Federal Trade Commission ( FTC ) will modify their regulations and policies governing the acquisition of additional radio stations in a market. In addition, we cannot predict whether a private party will challenge acquisitions we propose in the future. These events could adversely affect our ability to implement our cluster acquisition strategy.

***Government Regulation of the Broadcasting Industry by the FTC, DOJ and FCC May Limit Our Ability to Acquire or Dispose of Radio Stations and Enter Into Certain Agreements***

The Communications Act and FCC rules and policies require prior FCC approval for transfers of control of, and assignments of, FCC licenses. The FTC and the DOJ evaluate transactions to determine whether those transactions should be challenged under federal antitrust laws. Over the past eight years, the FTC and the DOJ have been increasingly active in their review of radio station acquisitions. This is particularly the case when a radio broadcast company proposes to acquire an additional station in an existing market. As we have gained a presence in a greater number of markets and percentage of the top 50 markets, our future proposed transactions may be subject to more frequent and aggressive review by the FTC or the DOJ due to market concentration concerns. This increased level of review may be accentuated in instances where we propose to engage in a transaction with parties who themselves have multiple stations in the relevant market. The FCC might not approve a proposed radio station acquisition or disposition when the DOJ has expressed market concentration concerns with respect to the buy or sell side of a given transaction, even if the proposed transaction would otherwise comply with the FCC s numerical limits on in-market ownership. We cannot be sure that the DOJ or the FTC will not seek to prohibit or require the restructuring of our future acquisitions or dispositions on these or other bases.

Were a complaint to be filed against us or other FCC licensees involved in a transaction with us, or an objection to the transaction itself, the FCC could delay the grant of, or refuse to grant, its consent to an assignment or transfer of control of licenses and effectively prohibit a proposed acquisition or disposition.

As noted in the immediately preceding risk factor, the FCC s local radio multiple ownership rules limit the maximum number of stations we may own or operate in a market. This may limit our ability to make future radio station acquisitions in certain markets. Additionally, this may limit our ability, in certain markets, to enter into agreements whereby we provide programming to or sell advertising on radio stations that we do not own. It could also limit our ability to sell stations to other entities that already own stations in some markets.

***We May Be Adversely Affected By New Statutes Dealing With Indecency***

Congress recently passed, and President Bush signed into law on June 15, 2006, the Broadcast Decency Enforcement Act of 2005 that enhances the FCC s enforcement of its rules concerning the broadcast of obscene, indecent, or profane material. This legislation increased the FCC s authority in this area to impose substantially higher monetary forfeiture penalties, up to $325,000 per violation and a total of $3,000,000 for any one incident. While we do not anticipate these increased penalties to impact us as significantly as some of our competitors given the nature of our programming, we could face increased costs in the form of fines as a result of this legislation.

***If We Fail To Maintain Our Licenses with the FCC, We Would Be Prevented From Operating Affected Radio Stations***

We operate each of our radio stations pursuant to one or more FCC broadcasting licenses, generally of eight years duration. As each license expires, we apply for renewal of the license. However, we cannot be sure that any of our licenses will be renewed, and renewal is subject to challenge by third-parties or to denial by the FCC. In evaluating a broadcasting license renewal application, the FCC must grant the renewal if: (1) the station has served the public interest, convenience and necessity; (2) there have been no serious violations of the Communications Act or the FCC s rules; and (3) there have been no other violations which, taken together, constitute a pattern of abuse If, however, the station fails to meet these standards, the FCC may deny the application, after notice and an opportunity for a hearing, or grant the application on terms and conditions that are appropriate, including renewal for less than the maximum term otherwise allowed.  The failure to renew any of our licenses would prevent us from operating the affected station and generating revenue from it.  If the FCC decides to include conditions or qualifications in any of our licenses, we may be limited in the manner in which we may operate the affected station.

***Capital Requirements Necessary to Implement Acquisitions Could Pose Risks***

We face stiff competition from other broadcasting companies for acquisition opportunities. If the prices sought by sellers of these companies were to rise, we may find fewer acceptable acquisition opportunities. In addition, the purchase price of possible acquisitions could require additional debt or equity financing on our part. Since the terms and availability of this financing depend to a large degree upon general economic conditions and third parties over which we have no control, we can give no assurance that we will obtain the needed financing or that we will obtain such financing on attractive terms. In addition, our ability to obtain financing depends on a number of other factors, many of which are also beyond our control, such as interest rates and national and local business conditions. If the cost of obtaining needed financing is too high or the terms of such financing are otherwise unacceptable in relation to the acquisition opportunity we are presented with, we may decide to forego that opportunity. Additional indebtedness could increase our leverage and make us more vulnerable to economic downturns and may limit our ability to withstand competitive pressures. Additional equity financing could result in dilution to our shareholders.

***If We Are Unable To Execute Our Acquisition Strategy Successfully, Our Business May Not Continue To Grow***

We intend to continue to acquire radio stations as well as complementary non-broadcast media businesses. With respect to the acquisition of radio stations, our acquisition strategy has been, and will continue to focus primarily on, the acquisition of stations in the top 50 markets. However, we may not be able to identify and consummate future acquisitions successfully, and stations that we do acquire may not increase our station operating income or yield other anticipated benefits. Acquisitions in markets in which we already own stations may not increase our station operating income due to saturation of audience demand. Acquisitions in smaller markets may have less potential to increase operating revenues. With respect to our acquisition strategy of non-broadcast media businesses, we may not be able to identify and consummate the acquisition of future non-broadcast media businesses successfully.  Additionally, we may not be able to effectively integrate the operation of newly acquired businesses with our existing businesses which could result in reduced operating income from our non-broadcast media businesses.  Our failure to execute our acquisition strategy successfully in the future could limit our ability to continue to grow in terms of number of stations or profitability.

***Because Of Our Holding Company Structure, We Depend On Our Subsidiaries for Cash Flow, and Our Access to This Cash Flow Is Restricted***

We operate as a holding company. All of our radio stations are currently owned and operated by our subsidiaries. Salem Holding, our wholly-owned subsidiary, is the borrower under our credit facilities and our senior subordinated debt. All of our station-operating subsidiaries are subsidiaries of Salem Communications Corporation. Further, we guaranteed Salem Holding s obligations under the credit facilities and under the senior subordinated notes.

As a holding company, our only source of cash to pay our obligations, including corporate overhead and other trade payables, are distributions from our subsidiaries of their net earnings and cash flow. We currently expect that the net earnings and cash flow of our subsidiaries will be retained and used by them in their operations, including servicing their debt obligations, before distributions are made to us. Even if our subsidiaries elect to make distributions to us, we cannot assure you that applicable state law and contractual restrictions, including the dividend covenants contained in our credit facilities and senior subordinated notes, would permit such dividends or distributions.

***Our Business is Dependent upon the Performance of Key Employees, On-Air Talent and Program Hosts***

Our business is dependent upon the performance and continued efforts of certain key individuals, particularly Edward G. Atsinger III, our President and Chief Executive Officer, and Stuart W. Epperson, our Chairman of the Board. The loss of the services of either of Messrs. Atsinger or Epperson could have a material adverse effect upon us. We have entered into employment agreements with each of Messrs. Atsinger and Epperson. Both agreements expire in June 2007. Mr. Epperson has radio interests unrelated to Salem s operations that will continue to impose demands on his time. Mr. Atsinger has an interest in an aviation business unrelated to Salem s operations that will continue to impose demands on his time.

We also employ or independently contract with several on-air personalities and hosts of syndicated radio programs with significant loyal audiences both on a national level and in their respective markets. Although we have entered into long-term agreements with some of our executive officers, key on-air talent and program hosts to protect our interests in those relationships, we can give no assurance that all or any of these key employees will remain with us or will retain their audiences. Competition for these individuals is intense and many of our key employees are at-will employees who are under no legal obligation to remain with us. Our competitors may choose to extend offers to any of these individuals on terms, which we may be unwilling to meet. In addition, any or all of our key employees may decide to leave for a variety of personal or other reasons beyond our control. Furthermore, the popularity and audience loyalty of our key on-air talent and program hosts is highly sensitive to rapidly changing public tastes. A loss of such popularity or audience loyalty is beyond our control and could limit our ability to generate revenues.

***We May Be Adversely Affected By New Statutes Dealing With Indecency***

Congress currently has under consideration legislation that addresses the FCC s enforcement of its rules concerning the broadcast of obscene, indecent, or profane material. Potential changes to enhance the FCC s authority in this area include the ability to impose substantially higher monetary forfeiture penalties, consider violations to be serious offenses in the context of license renewal applications, and, under certain circumstances, designate a license for hearing to determine whether such license should be revoked. While we do not anticipate these regulations to impact us as significantly as some of our competitors given the nature of our programming, in the event that this or similar legislation is ultimately enacted into law, we could face increased costs in the form of fines and a greater risk that we could lose one or more of our broadcasting licenses.

***If We Are Not Able To Obtain Financing or Generate Sufficient Cash Flows from Operations, We May Be Unable To Fund Future Acquisitions***

We may require significant financing to fund our acquisition strategy. This financing may not be available to us. The availability of funds under the credit facility at any time will be dependent upon, among other factors, our ability to satisfy financial covenants. Our future operating performance will be subject to financial, economic, business, competitive, regulatory and other factors, many of which are beyond our control. Accordingly, we cannot assure you that our future cash flows or borrowing capacity will be sufficient to allow us to complete future acquisitions or implement our business plan, which could have a material negative impact on our business and results of operations.

We may require significant financing to fund our acquisition strategy. This financing may not be available to us. The availability of funds under the credit facility at any time will be dependent upon, among other factors, our ability to satisfy financial covenants. Our future operating performance will be subject to financial, economic, business, competitive, regulatory and other factors, many of which are beyond our control. Accordingly, we cannot assure you that our future cash flows or borrowing capacity will be sufficient to allow us to complete future acquisitions or implement our business plan, which could result in the disposition of certain income-producing assets or otherwise have a material negative impact on our business and results of operations.

***Our Substantial Indebtedness and Our Ability to Incur More Indebtedness Could Adversely Affect Our Financial Condition***

We currently have a significant amount of indebtedness. At December 31, 2006, our total consolidated indebtedness was $361.0 million. Our substantial indebtedness could have important consequences, including:

- making it more difficult for us to satisfy our obligations with respect to borrowings under the credit facility and the subordinated notes;

- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions and other general corporate requirements;

- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing our ability to use our cash flow to fund future working capital, capital expenditures, acquisitions and other general corporate requirements;

- placing us at a competitive disadvantage relative to those of our competitors that have less indebtedness;

- limiting our flexibility in planning for, or reacting to, changes in our business and the industry that could make us more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in government regulations;

- subjecting us to higher interest expense in the event of increases in interest rates because some of our indebtedness is at variable rates of interest; and

- causing us to sell income-producing assets that have market value.

We may incur additional indebtedness to fund future acquisitions and for other corporate purposes. If new indebtedness is added to our and our subsidiaries current indebtedness levels, the related risks that we and they now face could intensify.



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***To Service Our Indebtedness And Other Obligations, We Will Require A Significant Amount Of Cash. Our Ability to Generate Cash Depends On Many Factors Beyond Our Control***

Our ability to make payments on and to refinance our indebtedness, to pay dividends and to fund capital expenditures will depend on our ability to generate cash in the future. This ability to generate cash, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our businesses might not generate sufficient cash flow from operations. We might not be able to complete future offerings, and future borrowings might not be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness on or before maturity. We cannot assure you that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all.

***If We Cannot Attract the Anticipated Listener, Programmer and Advertiser Base for Our Newly Acquired Radio Stations, We May Not Recoup Associated Operating Costs Or Achieve Profitability for These Radio Stations***

We frequently acquire selected assets of radio stations that previously broadcast in formats other than our primary formats. We continue to program some of these recently acquired stations in non-primary formats and we re-program others to one of our primary formats. During, and for a period after, the conversion of a radio station s format, the radio station typically generates operating losses. The magnitude and duration of these losses depends on a number of factors, including the promotional and marketing costs associated with attracting listeners and advertisers to our radio station s new format and the success of these efforts. There is no guarantee that the operation of these newly acquired stations or our operations in new formats will attract a sufficient listener and advertiser base. If we are not successful in attracting the listener and advertiser base we anticipate, we may not recoup associated operating costs or achieve profitability for these radio stations.

***If We Do Not Maintain or Increase Our Block Programming Revenues, Our Business and Operating Results May Be Adversely Affected***

The financial success of each of our radio stations that features Christian Teaching and Talk programming is dependent, to a significant degree, upon our ability to generate revenue from the sale of block programming time to national and local religious organizations, which accounted for 32.6% and 34.8% of our net broadcasting revenue during the years ended December 31, 2005, and 2006, respectively. We compete for this program revenue with a number of commercial and non-commercial radio stations. Due to the significant competition for this block programming, we may not be able to maintain or increase our current block programming revenue.

***If We Are Unable To Maintain or Grow Our Advertising Revenues, Our Business and Operating Results May Be Adversely Affected***

Our radio stations with our Christian Teaching and Talk, Contemporary Christian Music and News Talk formats are substantially dependent upon advertising for their revenues. In the advertising market, we compete for revenue with other commercial religious format and general format radio stations, as well as with other media, including broadcast and cable television, newspapers, magazines, direct mail, Internet and billboard advertising. Due to this significant competition, we may not be able to maintain or increase our current advertising revenue.

***A Sustained Economic Downturn in Key Salem Markets Could Negatively Impact Our Ability to Generate Broadcasting Revenues***

We derive a substantial part of our revenues from the sale of advertising on our radio stations. For the years ended December 31, 2004, 2005 and 2006, 54.0%, 54.0%, and 52.3% of our net broadcasting revenues, respectively, were generated from the sale of advertising. We are particularly dependent on revenue from stations in the Los Angeles and Dallas markets, which generated 8.5% and 7.1%, respectively, of our net broadcasting revenues in 2006. Because substantial portions of our revenues are derived from local advertisers in these key markets, our ability to generate revenues in those markets could be adversely affected by local or regional economic downturns.

***Environmental, Health, Safety and Land Use Laws and Regulations May Limit or Restrict Some of Our Operations***



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We must comply with various federal, state and local environmental, health, safety and land use laws and regulations which have a tendency to affect broadcast facilities differently than other uses. We and our properties are subject to such laws and regulations relating to the use, storage, disposal, emission and release of hazardous and non-hazardous substances and employee health and safety, as well as zoning restrictions which may affect, among other things, the ability for us to improve or relocate our radio broadcasting facilities. Historically, we have not incurred significant expenditures to comply with these laws. However, existing laws, and those which may be applied in the future, or a finding of a violation of or liability, could require us to make significant expenditures and otherwise limit or restrict some of our operations.

***Acts of War and Terrorism May Reduce Our Revenue and Have Other Negative Effects on Our Business***

In response to the September 11, 2001, terrorist attacks on New York City and Washington, D.C., we increased our news and community service programming, which decreased the amount of broadcast time available for commercial advertising and block programming. In addition, these events caused advertisers to cancel advertisements on our stations. Continued acts of war and terrorism against the United States, and the country s response thereto, including the current military actions in Iraq, may also cause a general slowdown in the U.S. advertising market, which could cause our revenues to decline due to advertising and/or programming cancellations, delays or defaults in payment, and other factors. In addition, these events may have other negative effects on our business, the nature and duration of which we cannot predict. If these acts of war or terrorism or weak economic conditions continue or worsen, our financial condition and results of operations may be materially and adversely affected.

***Our Controlling Stockholders May Cause Us to Act, or Refrain from Acting, In A Way That Minority Stockholders Do Not Believe Is In Their Best Interest***

As of March 10, 2007, Edward G. Atsinger III, Stuart W. Epperson, Nancy A. Epperson and Edward C. Atsinger controlled approximately 86.0% of the voting power of our capital stock. These four stockholders thus have the ability to control fundamental corporate transactions requiring stockholder approval, including but not limited to, the election of all of our directors, except for two directors elected by holders of our Class A common stock, approval of merger transactions involving Salem and the sale of all or substantially all of Salem s assets. The interests of any of these controlling stockholders may differ from the interests of our other stockholders and one or more of the controlling stockholders could take action or make decisions (or block action or decisions) that are not in the minority stockholders best interest.

***If We Fail To Maintain Our Licenses with the FCC, We Would Be Prevented From Operating Affected Radio Stations***

We operate each of our radio stations pursuant to one or more FCC broadcasting licenses. As each license expires, we apply for renewal of the license. However, we cannot be sure that any of our licenses will be renewed, and renewal is subject to challenge by third-parties or to denial by the FCC. The Communications Act and FCC rules and policies require prior FCC approval for transfers of control of, and assignments of, FCC licenses. Were a complaint to be filed against us or other FCC licensees involved in a transaction with us, the FCC could delay the grant of, or refuse to grant, its consent to an assignment or transfer of control of licenses and effectively prohibit a proposed acquisition or disposition. The failure to renew any of our licenses would prevent us from operating the affected station and generating revenue from it. If the FCC decides to include conditions or qualifications in any of our licenses, we may be limited in the manner in which we may operate the affected station.

***Covenant Restrictions Under Salem Holding s Credit Facility And Its Indentures Governing Its Outstanding Senior Subordinated Notes May Limit Our Ability To Operate Our Business***

Salem Holding s credit facility and the indentures governing its notes contain, among other things, covenants that restrict Salem s, Salem Holding s and their subsidiaries ability to finance future operations or capital needs or to engage in other business activities. The credit facility and each of such indentures restrict, among other things, our ability to:

- incur additional debt;
- pay dividends or make distributions;
- purchase or redeem stock;
- make investments and extend credit;
- engage in transactions with affiliates;

- create liens on assets;

- transfer and sell assets;

- extend radio site leases, and

- effect a consolidation or merger or sell, transfer, lease, or otherwise dispose of all or substantially all of their assets.

These restrictions on management s ability to operate Salem s and Salem Holding s business in accordance with their discretion could have a material adverse effect on our business. The covenants in each indenture of Salem Holding are subject to a number of important limitations and exceptions. These limitations and exceptions will, for example, allow Salem Holding to make certain restricted payments to, and investments in, Salem, subject to specified limitations.

In addition, Salem Holding s credit facility requires us to maintain specified financial ratios and satisfy certain financial condition tests which may require that we take action to reduce our debt or to act in a manner contrary to our business objectives. Events beyond our control, including changes in general economic and business conditions, may affect our ability to meet those financial ratios and financial condition tests. We cannot assure you that we will meet those tests or that the lenders will waive any failure to meet those tests. A breach of any of these covenants would result in a default under Salem Holding s credit facility and its existing indentures. If an event of default occurs under any of these agreements, the lenders could, under the credit facility, elect to declare all amounts outstanding thereunder, together with accrued interest, to be immediately due and payable.

If we are unable to pay our obligations to the lenders under the credit facility or other future senior debt instruments, the lenders could proceed against any or all of the collateral securing the indebtedness to them. The collateral under the credit facility consists of substantially all of our existing assets. In addition, a breach of certain of the restrictions or covenants in these agreements, or an acceleration by these lenders of the obligations to them, would cause a default under Salem Holding s notes. We may not have, or be able to obtain, sufficient funds to make accelerated payments, including payments on the notes, or to repay the notes in full after we pay the senior secured lenders to the extent of their collateral.

***We May be Adversely Affected by a General Deterioration in Economic Conditions***

The risks associated with our businesses become more acute in periods of a slowing economy or recession, which may be accompanied by a decrease in advertising.  A decline in the level of business activity of our advertisers could have an adverse effect on our revenues and profit margins. During the recent economic slowdown in the United States, many advertisers reduced their advertising expenditures. The impact of slowdowns on our business is difficult to predict, but they may result in reductions in purchases of advertising.

***Our Broadcasts Often Rely on Content Owned by Third Parties; Obtaining Such Content Could Be Costly and Require Us to Enter Into Disadvantageous License or Royalty Arrangements***

We rely heavily upon content and software owned by third parties in order to provide programming for our broadcasts. The cost of obtaining all necessary licenses and permission to use this third party content and software continues to increase. Although we attempt to avoid infringing known proprietary rights of third parties in our broadcasting efforts, we expect that we may be subject to legal proceedings and claims for alleged infringement from time to time in the ordinary course of business. Any claims relating to the infringement of third-party proprietary rights, even if not meritorious, could result in costly litigation, divert management s attention and resources, or require us to enter into royalty or license agreements which are not advantageous to us. In addition, parties making claims may be able to obtain an injunction, which could prevent us from broadcasting all or certain portions of individual radio broadcasts containing content owned by third parties. We also rely on software that we license from third parties, including software that is integrated with internally developed software and used to perform key broadcasting and accounting functions. We could lose the right to use this software or it could be made available to us only on commercially unreasonable terms. Although we believe that alternative software is available from other third-party suppliers or internal developments, the loss of or inability to maintain any of these software licenses or the inability of the third parties to enhance in a timely and cost-effective manner their products in response to changing customer needs, industry standards or technological developments could result in limitations or delays in broadcasting or accounting for programming by us until equivalent software could be developed internally or identified, licensed and integrated, which would harm our business.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not Applicable.

**ITEM 2. PROPERTIES.**

The types of properties required to support our radio stations include offices, studios and tower and antenna sites. A station s studios are generally located in an office in a downtown or business district. Tower and antenna sites are selected in areas that provide maximum market coverage. Our network operations are supported by offices and studios from which its programming originates or is relayed from a remote point of origination. The operations of our non-broadcast businesses are supported by office facilities.

Our radio stations studios and offices, as well as the operations of our non-broadcast businesses, are generally located in leased facilities. Our network leases satellite transponders used for delivery of its programming. We either own or lease our radio station tower and antenna sites. We believe we will be able to renew any such lease that expires or obtain comparable facilities, as necessary. We own our corporate office building, located in Camarillo, California, and the headquarters of SRN and SRR, located in the Dallas, Texas metropolitan area. Additionally, we own our studio and office facilities for our Tampa, Florida, Orlando, Florida, Cleveland, Ohio, Philadelphia, Pennsylvania, Phoenix, Arizona, and Honolulu, Hawaii operations.

We lease certain property from our principal stockholders or trusts and partnerships created for the benefit of the principal stockholders and their families. These leases are described in CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS in Part III, Item 13 and in Note 8 of our consolidated financial statements. All such leases have cost of living adjustments. Based upon our management s assessment and analysis of local market conditions for comparable properties, we believe such leases have terms that are as favorable, or more favorable, to the company than those that would have been available from unaffiliated parties.

No one physical property is material to our overall operations. We believe that our properties are in good condition and suitable for our operations; however, we continually evaluate opportunities to upgrade our properties.

**ITEM 3. LEGAL PROCEEDINGS.**

We and our subsidiaries, incident to our business activities, are parties to a number of legal proceedings, lawsuits, arbitration and other claims including the purported class action described below. 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.

On March 9, 2005, Pipefitters, Locals 522 and 633 Pension Trust Fund filed a Class Action Complaint for Violation of the Federal Securities Laws in the Superior Court of California for the County of Ventura against the Company, the Company directors, certain of the Company s officers and certain underwriters of the Company's April 2004 public offering of Class A common stock, on behalf of a putative class of all persons who purchased the Company's equity securities pursuant to or traceable to that offering. The complaint alleged that offering documents contained misstatements and omissions regarding the Company's fixed assets and internal controls. The complaint asserted claims under Sections 11, 12 and 15 of the Securities Act of 1933, and sought rescission or damages, interest, attorney's fees and costs, as well as equitable and injunctive relief. The parties entered into a Stipulation of Settlement dated as of February 7, 2006, which provided for a full settlement of these claims in exchange for payment of $1.85 million by the company and its insurance carrier. The court approved the full settlement at a hearing held on June 19, 2006. During 2005, the Company recognized expenses of $0.7 million related to this settlement.

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

No matters were submitted to a vote of stockholders, through the solicitation of proxies or otherwise, during the fourth quarter of fiscal 2006.

## PART II

### ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY; RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

The company s Class A common stock trades on the NASDAQ Global Market® ( NASDAQ-NGM ) under the symbol SALM. On March 9, 2007, the company had approximately 53 stockholders of record (not including the number of persons or entities holding stock in nominee or street name through various brokerage firms) and 18,296,324 outstanding shares of its Class A common stock and two stockholders of record and 5,553,696 outstanding shares of its Class B common stock. The following table sets forth for the fiscal quarters indicated the range of high and low trade price information per share of the Class A common stock of the company as reported on the NASDAQ-NGM.

| | 2005 | | | | 2006 | | | |
|---|---|---|---|---|---|---|---|---|
| | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr |
| High (mid-day) | $ 25.35 | $ 21.69 | $ 21.20 | $ 20.61 | $ 18.16 | $ 15.60 | $ 13.86 | $ 14.05 |
| Low (mid-day) | $ 20.02 | $ 16.44 | $ 16.95 | $ 17.11 | $ 12.85 | $ 11.42 | $ 9.95 | $ 11.63 |

There is no established public trading market for the company s Class B common stock.

### DIVIDEND POLICY

On July 28, 2006, the company paid a special cash dividend of $0.60 per share on its Class A and Class B common stock to shareholders of record as of the close of business on July 17, 2006. The cash payment amounted to approximately $14.6 million. Due to the transition of the radio broadcasting industry to a more mature stage of its lifecycle, a number of broadcasting peers have introduced special dividends. After careful review and consideration of its earnings, financial position, capital requirements, its bank credit facilities, the indentures governing its senior subordinated notes, the company determined that it was in the interest of its shareholders to grant a special dividend. The company s sole source of cash available for making any future dividend payments will be dividends paid to the company or payments made to the company by its subsidiaries. The ability of subsidiaries of the company to make such payments may be restricted by applicable state laws or terms of agreements to which they are or may become a party; the company s credit facility and the terms of the indentures governing its outstanding senior subordinated notes restrict the payment of dividends on its common stock unless certain specified conditions are satisfied.

During the twelve month period ended December 31, 2006, we made repurchases of our Class A common stock pursuant to share repurchase programs authorized by our Board of Directors as May 2005 and February 2006. This repurchase program will continue until the earlier of (a) December 31, 2007, (b) all desired shares are repurchased, or (c) the Repurchase Plan is terminated earlier by the Repurchase Plan Committee on behalf of Salem. The amount we may repurchase may be limited by certain restrictions under our credit facilities. During the twelve month period ended December 31, 2006, we made repurchases of our Class A common stock as follows:

**Repurchases of Class A Common Stock**

| **Period** | **Total Number of of Shares Purchased** | **Average Price Paid Per Share** | **Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs** | **Maximum Approximate Dollar Value of Shares That May Yet Be Purchased Under The Plans or Programs** |
|---|---|---|---|---|
| Jan. 1, 2006 Jan. 31, 2006 | 544,592 | 16.55 | 544,592 | $ 29,447,407 |
| Feb. 1, 2006 Feb. 28, 2006 | 283,323 | 14.58 | 283,323 | 25,317,837 |
| Mar. 1, 2006 - Mar. 31, 2006 | 151,460 | 13.24 | 151,460 | 23,311,930 |
| Apr. 1, 2006 Apr. 30, 2006 | -- | -- | -- | 23,311,930 |
| May 1, 2006 May 31, 2006 | -- | -- | -- | 23,311,930 |
| Jun. 1, 2006 Jun. 30, 2006 | -- | -- | -- | 23,311,930 |
| Jul. 1, 2006 Jul. 31, 2006 | -- | -- | -- | 23,311,930 |
| Aug. 1, 2006 Aug. 31,2006 | 502,250 | 10.80 | 502,250 | 17,885,857 |
| Sept. 1, 2006 Sept. 30, 2006 | 9,000 | 11.54 | 9,000 | 17,781,997 |
| Oct 1, 2006 Oct 31, 2006 | -- | -- | -- | 17,781,997 |
| Nov 1, 2006 Nov 30, 2006 | -- | -- | -- | 17,781,997 |
| Dec 1, 2006 Dec 31, 2006 | -- | -- | -- | 17,781,997 |
| Total | 1,490,625 | | 1,490,625 | |

**ITEM 6. SELECTED FINANCIAL DATA.**

The following table sets forth selected financial data and other operating information of Salem. The selected financial data in the table are derived from the consolidated financial statements of Salem. The data should be read in conjunction with the consolidated financial statements, related notes, and other financial information included (incorporated by reference) herein. The data below should be read in conjunction with, and is qualified by reference to, our consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations and specifically the disclosure concerning a reconciliation for historical Non-GAAP measures presented in Management s Discussion and Analysis of Financial Condition and Results of Operations Non-GAAP Financial Measures included in Item 7 of this report. The Statements of Operations Data for all periods presented have been reclassified to reflect the operating results of WTSJ-AM, Cincinnati, Ohio, WBOB-AM, Cincinnati, Ohio, WBTK-AM, Richmond, Virginia, WITH-AM, Baltimore, Maryland, WBGB-FM, Jacksonville, Florida, WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida, as discontinued operations. The Company entered into agreements to sell these radio stations during 2005 and 2006 and completed the sale of all discontinued operations as of the end of 2006.

**ITEM 6. SELECTED FINANCIAL DATA (CONTINUED).**

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | **2006** |
| | (Dollars in thousands, except share and per share data) | | | | |
| **Statement of Operations Data:** | | | | | |
| Net broadcasting revenue | $ 154,949 | $ 168,637 | $ 184,296 | $ 198,852 | **$ 208,400** |
| Non-broadcast revenue | 8,054 | 7,865 | 9,342 | 10,790 | **19,369** |
| Total revenue | 163,003 | 176,502 | 193,638 | 209,642 | **227,769** |
| Operating expenses: | | | | | |
| Broadcasting operating expenses | 102,651 | 106,812 | 112,334 | 121,462 | **131,117** |
| Cost of denied / abandoned tower site and license upgrade | | 2,202 | 746 | | |
| Non-broadcast operating expenses | 7,709 | 7,942 | 8,600 | 9,889 | **18,172** |
| Legal settlement | 2,300 | | | 650 | |
| Corporate expenses | 14,387 | 16,091 | 17,480 | 19,607 | **24,043** |
| Cost of terminated offering | | 651 | | | |
| Depreciation and amortization | 11,296 | 12,105 | 12,071 | 13,017 | **15,193** |
| (Gain) loss on disposal of assets | 567 | 214 | 3,217 | 527 | **(18,647)** |
| Total operating expenses | 138,910 | 146,017 | 154,448 | 165,152 | **169,878** |
| Operating income | 24,093 | 30,485 | 39,190 | 44,490 | **57,891** |
| Other income (expense): | | | | | |
| Interest income | 255 | 212 | 171 | 207 | **210** |
| Interest expense | (27,162) | (23,474) | (19,931) | (22,559) | **(26,342)** |
| Loss on early redemption of long-term debt | | (6,440) | (6,588) | (24) | **(3,625)** |
| Other income (expense) | (458) | (410) | (116) | (506) | **(420)** |
| Total other expense | (27,365) | (30,112) | (26,464) | (22,882) | **(30,177)** |
| Income (loss) from continuing operations before income taxes | (3,272) | 373 | 12,726 | 21,608 | **27,714** |
| Provision (benefit) for income | (1,307) | 701 | 4,859 | 8,570 | **11,167** |

| | | | | | |
|---|---|---|---|---|---|
| taxes | | | | | |
| Income (loss) from continuing operations | (1,965) | (328) | 7,867 | 13,038 | **16,547** |
| Income (loss) from discontinued operations, net of tax | 15,969 | (349) | (534) | (376) | **2,452** |
| Net income (loss) | $ 14,004 | $ (677) | $ 7,333 | $ 12,662 | **$ 18,999** |
| Basic earnings (loss) per share data: | | | | | |
| Earnings (loss) per share from continuing operations | $ (0.08) | $ (0.01) | $ 0.31 | $ 0.51 | **$ 0.68** |
| Income (loss) from discontinued operations | 0.68 | (0.01) | (0.02) | (0.01) | **0.10** |
| Net earnings (loss) per share | 0.60 | (0.02) | 0.29 | 0.49 | **0.78** |
| Diluted earnings (loss) per share data: | | | | | |
| Earnings (loss) per share from continuing operations | $ (0.08) | $ (0.01) | $ 0.31 | $ 0.51 | **$ 0.68** |
| Earnings (loss) per share from discontinued operations | 0.68 | (0.01) | (0.02) | (0.01) | **0.10** |
| Net earnings (loss) per share | 0.59 | (0.03) | 0.29 | 0.49 | **$ 0.78** |
| Basic weighted average shares outstanding | 23,473,821 | 23,488,898 | 25,220,678 | 25,735,641 | **24,215,867** |
| Diluted weighted average shares outstanding | 23,582,906 | 23,488,898 | 25,371,649 | 25,794,875 | **24,223,751** |

**ITEM 6. SELECTED FINANCIAL DATA (CONTINUED).**

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | **2006** |
| | (Dollars in thousands) | | | | |
| **Balance Sheet Data:** | | | | | |
| Cash and cash equivalents | $ 26,325 | $ 5,620 | $ 10,994 | $ 3,979 | **$ 710** |
| Restricted cash | 107,661 | | | | |
| Broadcast licenses | 361,349 | 372,016 | 396,542 | 443,092 | **476,544** |
| Other intangible assets including goodwill, net | 17,305 | 15,387 | 14,172 | 20,047 | **31.866** |
| Total assets | 672,209 | 560,011 | 585,374 | 645,930 | **686,264** |
| Long-term debt, less current portion | 350,908 | 336,091 | 280,614 | 326,685 | **358,978** |
| Stockholders equity | 171,928 | 171,822 | 247,637 | 249,118 | **237,716** |
| **Cash flows related to:** | | | | | |
| Operating activities | $ 6,617 | $ 24,043 | $ 38,933 | $ 38,903 | **$ 36,661** |
| Investing activities | (26,926) | (19,790) | (44,157) | (83,422) | **(50,561)** |
| Financing activities | 22,608 | (14,883) | 10,923 | 37,548 | **(3,773)** |
| **Other Data:** | | | | | |
| Station operating income (1) | $ 52,298 | $ 61,825 | $ 71,962 | $ 77,390 | **$ 77,283** |
| Station operating income margin (2) | 33.8% | 36.7% | 39.0% | 38.9% | **37.1%** |

(1)

We define station operating income as net broadcasting revenue less broadcasting operating expenses.

(2)

Station operating income margin is station operating income as a percentage of net broadcasting revenue.

Station operating income is not a measure of performance calculated in accordance with generally accepted accounting principles ( GAAP ). Therefore it should be viewed as a supplement to and not a substitute for results of operations presented on the basis of GAAP. Management believes that station operating income is useful, when considered in conjunction with operating income, the most directly comparable GAAP financial measure, because it is generally recognized by the radio broadcasting industry as a tool in measuring performance and in applying valuation methodologies for companies in the media, entertainment and communications industries. This measure is used by investors and by analysts who report on the industry to provide comparisons between broadcast groups. Additionally, we use station operating income as one of our key measures of operating efficiency and profitability. Station operating income does not purport to represent cash provided by operating activities. Our statement of cash flows presents our cash flow activity and our income statement presents our historical performance prepared in accordance with GAAP. Our station operating income is not necessarily comparable to similarly titled measures employed by other companies.

**RECONCILIATION OF STATION OPERATING INCOME TO OPERATING INCOME**

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | **2006** |
| | (Dollars in thousands) | | | | |
| Station operating income | $ 52,298 | $ 61,825 | $ 71,962 | $ 77,390 | **$ 77,283** |
| Plus non-broadcast revenue | 8,054 | 7,865 | 9,342 | 10,790 | **19,369** |
| Less cost of denied tower site and license upgrade | | (2,202) | (746) | | |
| Less non-broadcast operating expenses | (7,709) | (7,942) | (8,600) | (9,889) | **(18,172)** |
| Less depreciation and amortization | (11,296) | (12,105) | (12,071) | (13,017) | **(15,193)** |
| Less gain (loss) on disposal of assets | (567) | (214) | (3,217) | (527) | **18,647** |
| Less corporate expenses | (14,387) | (16,091) | (17,480) | (19,607) | **(24,043)** |
| Less cost of terminated offering | | (651) | | | |
| Less legal settlement | (2,300) | | | (650) | |
| Operating income | $ 24,093 | $ 30,485 | $ 39,190 | $ 44,490 | **$ 57,891** |

**ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**GENERAL**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. Our consolidated financial statements are not directly comparable from period to period because of our acquisition and disposition of selected assets of radio stations and our acquisition of selected assets of non-broadcast businesses. See Note 2 to our consolidated financial statements under Item 8 for additional information.

**OVERVIEW**

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

Historically, our principal sources of revenue have been:

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

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

- audience share,
- how well our stations perform for our clients,
- the size of the market,
- the general economic conditions in each market, and
- 

supply and demand on both a local and national level.

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

The following table shows the percentage of net broadcasting revenue for each broadcasting revenue source.

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2004 | | 2005 | | **2006** | |
| | (Dollars in thousands) | | | | | |
| Block program time: | | | | | | |
| National | $ 34,773 | 18.9% | $ 36,546 | 18.4% | **$41,518** | **19.9%** |
| Local | 24,327 | 13.2 | 28,208 | 14.2 | **31,047** | **14.9** |
| | 59,100 | 32.1 | 64,754 | 32.6 | **72,565** | **34.8** |
| Advertising: | | | | | | |
| National | 14,358 | 7.8 | 15,647 | 7.9 | **17,519** | **8.4** |
| Local | 85,188 | 46.2 | 91,767 | 46.1 | **91,530** | **43.9** |
| | 99,546 | 54.0 | 107,414 | 54.0 | **109,049** | **52.3** |
| Infomercials | 8,093 | 4.4 | 8,129 | 4.0 | **7,837** | **3.8** |
| Network | 14,053 | 7.6 | 14,664 | 7.4 | **14,834** | **7.1** |
| Other | 3,504 | 1.9 | 3,891 | 2.0 | **4,115** | **2.0** |
| Net broadcasting revenue | $184,296 | 100% | $ 198,852 | 100% | **$208,400** | **100%** |

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

As is typical in the radio broadcasting industry, our second and fourth quarter advertising revenue generally exceeds our first and third quarter advertising revenue. This seasonal fluctuation in advertising revenue corresponds with quarterly fluctuations in the retail advertising industry. Quarterly revenue from the sale of block programming time does not tend to vary significantly, however, because program rates are generally set annually and are recognized on a per program basis.

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

In the broadcasting industry, radio stations often utilize trade or barter agreements to exchange advertising time for goods or services (such as non-broadcast advertising, travel or lodging) in lieu of cash. In order to preserve the sale of our advertising time for cash, we generally enter into trade agreements only if the goods or services bartered to us will be used in our business. We have minimized our use of trade agreements and have generally sold most of our advertising time for cash. In 2006, we sold 96% of our advertising time for cash. In addition, it is our general policy not to preempt advertising paid for in cash with advertising paid for in trade.

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

Salem Web Network™ and Towhanll.com, our Internet businesses, earn 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 revenue from the publishing of books. The revenue and related operating expenses of these businesses are reported as non-broadcast on our Consolidated Statement of Operations.

**SAME STATION DEFINITION**

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

**RESULTS OF OPERATIONS**

We have reclassified our statements of operations data for all periods presented to reflect the operating results of WTSJ-AM, Cincinnati, Ohio, WBOB-AM, Cincinnati, Ohio, WBTK-AM, Richmond, Virginia, WITH-AM, Baltimore, Maryland, WBGB-FM, Jacksonville, Florida, WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida, and WZAZ-AM, Jacksonville, Florida, as discontinued operations. The Company entered into agreements to sell these radio stations during 2005 and 2006 and completed the sale of all discontinued operations as of the end of 2006.

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

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2005 | **2006** | 2005 over 2004 | 2006 over 2005 |
| | | (in thousands) | | | % change |
| Net broadcasting revenue | $ 184,296 | $ 198,852 | **$ 208,400** | 7.9% | 4.8% |
| Non-broadcast revenue | 9,342 | 10,790 | **19,369** | 15.5% | 79.5% |
| Total revenue | 193,638 | 209,642 | **227,769** | 8.3% | 8.6% |
| Operating expenses: | | | | | |
| Broadcasting operating expenses | 112,334 | 121,462 | **131,117** | 8.1% | 7.9% |
| Cost of denied / abandoned tower site and license upgrade | 746 | | | (100)% | |
| Non-broadcast operating expenses | 8,600 | 9,889 | **18,172** | 15.0% | 83.8% |
| Legal settlement | | 650 | | | (100)% |
| Corporate expenses | 17,480 | 19,607 | **24,043** | 12.2% | 22.6% |
| Depreciation | 10,538 | 11,557 | **12,073** | 9.7% | 4.5% |
| Amortization | 1,533 | 1,460 | **3,120** | (4.8)% | 113.7% |
| (Gain) / Loss on disposal of assets | 3,217 | 527 | **(18,647)** | (83.6)% | (3,638.3)% |
| Total operating expenses | 154,448 | 165,152 | **169,878** | 6.9% | 2.9% |
| Operating income from continuing operations | 39,190 | 44,490 | **57,891** | 13.5% | 30.1% |
| Other income (expense): | | | | | |
| Interest income | 171 | 207 | **210** | 21.1% | 1.4% |
| Interest expense | (19,931) | (22,559) | **(26,342)** | 13.2% | 16.8% |
| Loss on early redemption of long-term debt | (6,588) | (24) | **(3,625)** | (99.6)% | 15,004.2% |
| Other expense, net | (116) | (506) | **(420)** | 336.2% | (17.0)% |
| Income from continuing operations before income taxes | 12,726 | 21,608 | **27,714** | 69.8% | 28.3% |
| Provision for income taxes | 4,859 | 8,570 | **11,167** | 76.4% | 30.3% |
| Income from continuing operations | 7,867 | 13,038 | **16,547** | 65.7% | 26.9% |
| Income (loss) from discontinued operations, net of tax | (534) | (376) | **2,452** | (29.6)% | (752.1)% |

| | | | | | |
|---|---|---|---|---|---|
| Net income | $ 7,333 | $ 12,662 | **$ 18,999** | 72.7% | 50.0% |

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

| | Year Ended December 31, 2004 | 2005 | **2006** |
|---|---|---|---|
| Net broadcasting revenue | 95 % | 95 % | **92 %** |
| Non-broadcast revenue | 5 % | 5 % | **8 %** |
| Total revenue | 100 % | 100 % | **100 %** |
| Operating expenses: | | | |
| Broadcasting operating expenses | 58 % | 58 % | **58 %** |
| Cost of denied/abandoned tower site and license upgrade | % | % | **%** |
| Non-broadcast operating expenses | 4 % | 5 % | **8 %** |
| Legal settlement | % | % | **%** |
| Corporate expenses | 9 % | 9 % | **11 %** |
| Depreciation | 6 % | 6 % | **5 %** |
| Amortization | 1 % | 1 % | **1 %** |
| (Gain) Loss on disposal of assets | 2 % | % | **(8) %** |
| Total operating expenses | 80 % | 79 % | **75 %** |
| Operating income from continuing operations | 20 % | 21 % | **25 %** |
| Other income (expense): | | | |
| Interest income | % | % | **%** |
| Interest expense | (10) % | (11) % | **(12) %** |
| Loss on early redemption of long-term debt | (3) % | % | **(1) %** |
| Other expense, net | % | % | **%** |
| Income from continuing operations before income taxes | 7 % | 10 % | **12 %** |
| Provision for income taxes | 3 % | 4 % | **5 %** |
| Income from continuing operations | 4 % | 6 % | **7 %** |
| Income from discontinued operations, net of tax | % | % | **1 %** |
| Net income | 4 % | 6 % | **8 %** |

***Year ended December 31, 2006 compared to year ended December 31, 2005***

*NET BROADCASTING REVENUE.* Net broadcasting revenue increased $9.5 million or 4.8% to $208.4 million for the year ended December 31, 2006, from $198.9 million for the year ended December 31, 2005. On a same station basis, net broadcasting revenue improved $4.8 million, or 2.4% to $200.6 million for the year ended December 31, 2006, from $195.8 million for the year ended December 31, 2005. This revenue growth is attributable primarily to increases in net broadcasting revenue on our Christian Teaching and Talk stations of $3.7 million and in net broadcasting revenue on our News Talk stations of $2.4 million. Revenue from advertising as a percentage of our net broadcasting revenue decreased to 52.3% for the year ended December 31, 2006, from 54.0% for the year ended December 31, 2005. Revenue from block program time as a percentage of our net broadcasting revenue increased to 34.8% for year ended December 31, 2006, from 32.6% for the year ended December 31, 2005. This change in our revenue mix was primarily due to weakness in the radio advertising market, additional program revenue on our News Talk stations and continued program revenue growth on our Christian Teaching and Talk stations.

*NON-BROADCAST REVENUE.* Non-broadcast revenue increased $8.6 million, or 79.5% to $19.4 million for the year ended December 31, 2006, from $10.8 million for the year ended December 31, 2005. The increase was primarily due to our acquisitions of Churchstaffing.com in the fourth quarter of 2005 and our acquisitions of Singing News, CrossDaily.com, Townhall.com, and Xulon Press during 2006 plus organic growth of advertising revenue at Salem Web Network™.

*BROADCASTING OPERATING EXPENSES.* Broadcast operating expenses increased $9.6 million, or 7.9% to $131.1 million for the year ended December 31, 2006, compared to $121.5 million for the year ended December 31, 2005. On a same station basis, broadcast operating expense increased $5.3 million or 4.5% to $123.3 million for the year ended December 31, 2006, compared to $118.0 million for the year ended December 31, 2005. The increase is primarily attributable to higher personnel costs of $3.8 million, including stock based compensation of $0.8 million which was not applicable during the same period of the prior year and including commissions of $0.1 million associated with higher sales, higher advertising costs of $0.5 million, higher facility related costs of $0.6 million associated with recently acquired facilities and higher production costs of $1.2 million associated with station programming.

*NON-BROADCAST OPERATING EXPENSES.* Non-broadcast operating expenses increased $8.3 million, or 83.8% to $18.2 million for the year ended December 31, 2006, compared to $9.9 million for the year ended December 31, 2005. The increase is attributable primarily to costs associated with our acquisitions of Churchstaffing.com in the fourth quarter of 2005 and our acquisitions of Singing News, CrossDaily.com, Townhall.com, and Xulon Press during 2006.

*LEGAL SETTLEMENT.* During the year ended December 31, 2005, we recorded a $0.7 million expense related to a stipulation of settlement of a class action lawsuit.

*CORPORATE EXPENSES.* Corporate expenses increased $4.4 million, or 22.65%, to $24.0 million for the year ended December 31, 2006, compared to $19.6 million for the year ended December 31, 2005. The increase is primarily due to $3.5 million of non-cash stock-based compensation expense associated with the implementation of SFAS No. 123R, Share-Based Payment on January 1, 2006, higher personnel costs of $0.3 million, higher research and development costs of $0.2 million and $0.3 million of costs associated with compliance requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

*DEPRECIATION AND AMORTIZATION.* Depreciation expense increased $0.5 million, or 4.5%, to $12.1 million for the year ended December 31, 2006, compared to $11.6 million for the year ended December 31, 2005. The increase is primarily due to depreciation associated with the acquisitions of radio station assets and non-broadcast entities during 2006. Amortization expense increased $1.6 million, or 113.7%, to $3.1 million for the year ended December 31, 2006, compared to $1.5 million for the year ended December 31, 2005. The increase in amortization is primarily due to definitive lived assets acquired with non-broadcast media entities during 2005 and 2006.

*(GAIN) LOSS ON DISPOSAL OF ASSETS.* Gain on disposal of assets of $18.6 million for the year ended December 31, 2006, was primarily due to gains recognized on various exchange transactions accounted for under SFAS No. 153. Radio station KLMG-FM, Sacramento, California, was exchanged for selected assets of radio station KKFS-FM, Sacramento, California, which resulted in a pre-tax gain of $14.6 million. Additionally, we sold radio station WCCD-AM in Cleveland, Ohio, for $2.1 million resulting in a pre-tax gain of $1.6 million, which was primarily offset by the sale of radio station KBAA-FM, Sacramento, California, for $0.5 million, resulting in a pre-tax loss of $0.6 million. We also exchanged radio station KNIT-AM, Dallas, Texas for selected assets of radio

station WORL-AM, Orlando, Florida, resulting in a pre-tax gain on the exchange of $3.5 million. Loss on disposal of assets of $0.5 million for the year ended December 31, 2005, was primarily due to the write-off of various fixed assets and equipment.

*OTHER INCOME (EXPENSE).* Interest expense increased $3.7 million, or 16.8% to $26.3 million for the year ended December 31, 2006, compared to $22.6 million for the year ended December 31, 2005. The increase in interest expense is due to higher interest rates under our credit facilities and an increase in our net outstanding debt throughout the year. Net other expense of $0.4 million relates primarily to bank commitment fees associated with our credit facilities. During the year ended December 31, 2006, we recognized a pre-tax loss of approximately $3.6 million on the redemption of our 9% senior subordinated notes due July 2011, which includes the write-off of unamortized bond issue costs and interest rate swap settlement amounts.

*PROVISION FOR INCOME TAXES.* Provision for income taxes was $11.2 million for the year ended December 31, 2006 compared to $8.6 million for the year ended December 31, 2005. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 40.3% for the year ended December 31, 2006 compared to 39.7% for the year ended December 31, 2005. The effective tax rate for each period differs from the federal statutory income rate of 35.0% due to the effect of state income taxes, certain expenses that are not deductible for tax purposes, and changes in the valuation allowance from the utilization of certain state net operating loss carryforwards.

*INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX.* The income from discontinued operations was approximately $2.5 million, net of tax, for the year ended December 31, 2006, compared to a loss of $0.4 million, net of tax for the prior year. The gain includes a pre-tax gain of $0.8 million from the sale of WBGB-FM, Jacksonville, Florida and a pre-tax gain of $0.6 million from the sale of WBTK-AM in Richmond, Virginia. The gain also includes a pre-tax gain of $2.2 million from the sale of WITH-AM, Baltimore, Maryland and a pre-tax gain of $0.1 million for the sale of WJGR-AM, WZNZ-AM, and WZAZ-AM, Jacksonville, Florida. The loss of $0.4 million for the prior year represents the operating results of WTSJ-AM, WBOB-AM, WBTK-AM, WITH-AM, WBGB-FM, WJGR-AM, WZNZ-AM, and WZAZ-AM as discontinued operations to conform to the current period presentations.

*NET INCOME.* We recognized net income of $19.0 million for the year ended December 31, 2006 compared to net income of $12.7 million for the year ended December 31, 2005. This increase of $6.3 million is comprised of a $19.2 million increase in (gain) losses on disposal of assets, a $9.5 million increase in net broadcast revenue and a $8.6 million increase in non-broadcast revenue offset by a $9.4 million increase in broadcast expenses (exclusive of stock based compensation), a $8.2 million increase in non-broadcast expenses (exclusive of stock-based compensation), an increase of $4.3 million for total stock based compensation expense, a $3.7 million increase in interest expense, a $3.6 million charge on the early redemption of debt, and a $2.6 million increase in our provision for income taxes.

***Year ended December 31, 2005 compared to year ended December 31, 2004***

*NET BROADCASTING REVENUE.* Net broadcasting revenue increased $14.6 million or 7.9% to $198.9 million for the year ended December 31, 2005, from $184.3 million for the year ended December 31, 2004. On a same station basis, net broadcasting revenue improved $21.4 million, or 12.3% to $195.8 million for the year ended December 31, 2005, from $174.4 million for the year ended December 31, 2004. This revenue growth is attributable primarily to an increase in local spot and local program revenue of $7.5 million on our News Talk stations and an increase in national and local program sales of $4.0 million on our Christian Teaching and Talk stations. Revenue from advertising as a percentage of our net broadcasting revenue remained at 54% compared to the prior year. Revenue from block program time as a percentage of our net broadcasting revenue increased to 32.6% for the year ended December 31, 2005, from 32.1% for the year ended December 31, 2004. This change in our revenue mix is primarily due to additional program revenue on our News Talk stations and continued revenue growth on our Christian Teaching and Talk stations.

*NON-BROADCAST REVENUE.* Non-broadcast revenue increased $1.5 million, or 15.5% to $10.8 million for the year ended December 31, 2005, from $9.3 million for the year ended December 31, 2004. The increase is primarily due to a $0.5 million increase in banner advertising, an increase in radio streaming of $0.5 million, and an increase in online job posting revenue of $0.2 million as a result of our acquisition of the assets of the Internet portal operations of Christianjobs.com in the third quarter of 2004.

*BROADCASTING OPERATING EXPENSES.* Broadcast operating expenses increased $9.1 million, or 8.1% to $121.5 million for the year ended December 31, 2005, compared to $112.3 for the year ended December 31, 2004. On a same station basis, broadcast operating expense increased $15.5 million or 15.1% to $117.9 million for the year ended December 31, 2005, compared to $102.4 million for the year ended December 31, 2004. The increase is primarily due to higher payroll and related costs of $6.3 million, higher rent and utility costs of $2.0 million primarily associated with recently acquired facilities and increased marketing and promotional expense of $0.8 million related to our Christian music stations and the rollout of News Talk format in new markets.

*COST OF DENIED / ABANDONED TOWER SITE AND LICENSE UPGRADE.* During 2004 we wrote off $0.7 million of project costs incurred to upgrade our radio station technical facilities and FCC licenses.

*NON-BROADCAST OPERATING EXPENSES.* Non-broadcast operating expenses increased $1.3 million, or $15.0% to $9.9 million for the year ended December 31, 2005, compared to $8.6 million for the year ended December 31, 2004. The increase is primarily due to our acquisition of the assets of the Internet portal operations of Christianjobs.com in the third quarter of 2004 and the acquisition of the Internet portal operations of Christianity.com in the first quarter of 2005.

*LEGAL SETTLEMENT.* During the year ended December 31, 2005, we recorded a $0.7 million expense related to a stipulation of settlement of a class action lawsuit.

*CORPORATE EXPENSES.* Corporate expenses increased $2.1 million, or 12.2%, to $19.6 million for the year ended December 31, 2005, compared to $17.5 million for the year ended December 31, 2004. The increase is primarily due to increased overhead costs of $1.5 million associated with the growth of the company and higher audit and accounting fees of $0.6 million primarily associated with the compliance requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

*DEPRECIATION AND AMORTIZATION.* Depreciation expense increased $1.0 million, or 9.7%, to $11.6 million for the year ended December 31, 2005, compared to $10.5 for the year ended December 31, 2004. The increase is primarily due to depreciation associated with the acquisitions of radio station assets and Internet business assets during 2005. Amortization expense was $1.5 million in each of the years ended December 31, 2004 and 2005.

*(GAIN) LOSS ON DISPOSAL OF ASSETS.* Loss on disposal of assets of $0.5 million for the year ended December 31, 2005, was primarily due to the write-off of various fixed assets and equipment. Loss on disposal of fixed assets of $3.2 million for year ended December 31, 2004, was primarily due to the results of a physical inventory of our property plant and equipment and included an additional $0.2 million loss from the disposition of certain studio and production equipment being sold in connection with the early termination of a lease with a related party.

*OTHER INCOME (EXPENSE).* Interest income of $0.2 million for the year ended December 31, 2005 and 2004 was interest earned on excess cash. Interest expense increased $2.7 million, or 13.2% to $22.6 million for the year ended December 31, 2005, compared to $19.9 for the year ended December 31, 2004. The increase in interest expense was primarily due to increased borrowings on our credit facilities and higher interest rates as well as reduced interest savings of $3.0 million realized from interest rate swaps, partially offset with savings of $2.3 million due to the redemption of $55.6 million of our 9% Notes. Net other expense of $0.5 million relates primarily to bank commitment fees associated with our credit facilities.

*PROVISION FOR INCOME TAXES.* Provision for income taxes was $8.6 million for the year ended December 31, 2005 compared to $4.9 million for the year ended December 31, 2004. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 39.7% for the year ended December 31, 2005 compared to 38.2% for the year ended December 31, 2004. The effective tax rate for each period differs from the federal statutory income rate of 35.0% due to the effect of state income taxes, certain expenses that are not deductible for tax purposes, and changes in the valuation allowance from the utilization of certain state net operating loss carryforwards.

*INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX.* The loss from discontinued operations of $0.4 million, net of tax, for the year ended December 31, 2005, includes the recovery of a legal settlement of $0.3 million associated with the sale of WYGY-FM, Cincinnati, Ohio, in September 2002, and the net operating results of stations WTSJ-AM, Cincinnati Ohio, WBOB-AM, Cincinnati, Ohio, WBTK-AM, Richmond, Virginia, WITH-AM, Baltimore, Maryland, WBGB-FM, Jacksonville, Florida, WJGR-AM Jacksonville, Florida, WZNZ-AM Jacksonville, Florida, and WZAZ-AM Jacksonville, Florida. As described in Note 2 to our financial statements, we entered into agreements to sell these radio stations during 2005 and 2006. All prior periods have been revised to reflect the operating results of these stations as discontinued operations. Also included in the 2004 loss from discontinued operations is a $91,000 charge, net of tax, related to an increase in a liability associated with the sale of WYGY-FM, Cincinnati, Ohio.

*NET INCOME.* We recognized net income of $12.7 million for the year ended December 31, 2005 compared to net income of $7.3 million for the year ended December 31, 2004. This increase of $5.4 million is primarily due to an increase in income from continuing operations of $5.2 million and a decrease on loss on early redemption of debt of $6.6 million offset by an increase in interest expense of $2.6 million and an increase in the provision for income taxes of $3.7 million.

**NON-GAAP FINANCIAL MEASURES**

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

SOI is not a measure of performance calculated in accordance with GAAP; 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.

***Year ended December 31, 2006 compared to year ended December 31, 2005***

*STATION OPERATING INCOME.* SOI decreased $0.1 million, or 0.1% to $77.3 million for the year ended December 31, 2006, compared to $77.4 million for the year ended December 31, 2005 as a result of the changes in net broadcasting revenue and broadcast operating expense explained above. As a percentage of net broadcasting revenue, SOI decreased to 37.1% for the year ended December 31, 2006 from 38.9% for the year ended December 31, 2005. On a same station basis, SOI declined $0.5 million, or 0.6%, to $77.4 million for the year ended December 31, 2006 from $77.9 million for the year ended December 31, 2005. As a percentage of same station net broadcasting revenue, same station SOI decreased to 38.6% for the year ended December 31, 2006 compared to 39.8% for the year ended December 31, 2005.

The following table provides a reconciliation of SOI (a non-GAAP financial measure) to operating income (as presented in our financial statements) for the year ended December 31, 2006 and 2005:

| | For the Year Ended December 31, (Dollars in thousands) | |
|---|---|---|
| | 2005 | **2006** |
| Station operating income | $ 77,390 | **$ 77,283** |
| Plus non-broadcast revenue | 10,790 | **19,369** |
| Less non-broadcast operating expenses | (9,889) | **(18,172)** |
| Less depreciation and amortization | (13,017) | **(15,193)** |
| Less gain (loss) on disposal of assets | (527) | **18,647** |
| Less corporate expenses | (19,607) | **(24,043)** |
| Less legal settlement | (650) | |
| Operating income | $ 44,490 | **$ 57,891** |

***Year ended December 31, 2005 compared to year ended December 31, 2004***

*STATION OPERATING INCOME.* SOI increased $5.4 million, or 7.5% to $77.4 million for the year ended December 31, 2005, compared to $72.0 million for the year ended December 31, 2004 as a result of the changes in net broadcasting revenue and broadcast operating expense explained above. As a percentage of net broadcasting revenue, SOI decreased to 38.9% for the year ended December 31, 2005 from 39% for the year ended December 31, 2004. On a same station basis, SOI improved $5.9 million, or 8.2%, to $77.9 million for the year ended December 31, 2005 from $72.0 million for the year ended December 31, 2004. As a percentage of same station net broadcasting revenue, same station SOI increased to 39.8% for the year ended December 31, 2005 from 41.3% for the year ended December 31, 2004

The following table provides a reconciliation of SOI (a non-GAAP financial measure) to operating income (as presented in our financial statements) for the year ended December 31, 2005 and 2004:

| | For the Year Ended December 31, (Dollars in thousands) | |
|---|---|---|
| | 2004 | 2005 |
| Station operating income | $ 71,962 | $ 77,390 |
| Plus non-broadcast revenue | 9,342 | 10,790 |
| Less cost of denied / abandoned tower site and license upgrade | (746) | |
| Less non-broadcast operating expenses | (8,600) | (9,889) |
| Less depreciation and amortization | (12,071) | (13,017) |
| Less loss on disposal of assets | (3,217) | (527) |
| Less corporate expenses | (17,480) | (19,607) |

| | | | | |
|---|---|---|---|---|
| Less legal settlement | | | | (650) |
| Operating income | $ | 39,190 | $ | 44,490 |

**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to 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 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.

***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.

***Intangible assets***

Under the Financial Accounting Standards Board s rules, SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, we no longer amortize goodwill and intangible assets deemed to have indefinite lives, but perform annual impairment tests in accordance with these statements. We believe our FCC licenses have indefinite lives and accordingly amortization expense is no longer recorded for our FCC licenses as well as our goodwill. Other intangible assets continue to be amortized over their useful lives.

We perform impairment tests on our FCC licenses and goodwill at least annually. The annual tests are performed during the fourth quarter of each year and include comparing the recorded values to the appraised values, calculations of discounted cash flows, operating income and other analyses. As of December 31, 2006, no impairment was recognized. The assessment of the fair values of these assets and the underlying businesses are estimates, which require careful consideration and judgments by our management. If conditions in the markets in which our stations and non-broadcast businesses operate or if the operating results of our stations and non-broadcast businesses change or fail to develop as anticipated, our estimates of the fair values may change in the future and may result in impairment charges.

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

For financial reporting purposes, the company has recorded a valuation allowance of $4.8 million as of December 31, 2006, 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***

The Company has one stock option 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 December 31, 2006, a maximum of 3,100,000 shares are authorized under the plan, of which 2,159,604 are outstanding and 1,309,337 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 during 2006 was $4.3 million. 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. The assumptions for expected volatility and expected life are the two assumptions that significantly affect the grant date fair value. The expected dividend rate and expected risk-free rate of return are not currently significant to the calculation of fair value.

**RECENT ACCOUNTING PRONOUNCEMENTS**

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

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

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

On September 15, 2006, 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. We believe that the adoption of SFAS No. 157 will not have a material impact on the company s results of operations, cash flows or financial position.

***Statement of Financial Accounting Standards No. 153***

In December 2004, the FASB issued SFAS No. 153, Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29, which addresses the measurement of exchanges of non-monetary assets and eliminates the exception from fair value accounting for non-monetary exchanges of similar productive assets and replaces it with an exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a non-monetary exchange has commercial substance if the future cash flows of an entity are expected to change significantly as a result of the exchange. This statement was effective for us beginning in the first quarter of fiscal year 2006 and had a significant impact on our results of operations, cash flows and financial position. As a result of this accounting pronouncement, we recognized a net gain on exchanges of radio stations of $18.7 million for the year ended December 31, 2006, which is reported in discontinued operations and in (gain) loss on disposal of assets.

***FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109)***

In July 2006, the FASB issued FASB Interpretation ( FIN ) No. 48, Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109) . FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective beginning January 1, 2007, and the cumulative effect adjustment, if any, will be recorded in the first quarter of 2007. We continue to evaluate the impact of FIN No. 48 on our consolidated financial statements. At this time, we do not know what the impact will be upon the adoption of this standard.

***Staff Accounting Bulletin No. 108***

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, ( SAB 108 ). The interpretations in SAB 108 are being issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. SAB 108 is effective for the first interim period of the first fiscal year ending after November 15, 2006. SAB 108 was effective for us beginning in 2006 and there were no adjustments to opening retained earnings resulting from its application.

## 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. 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.

*Cash*. Cash and cash equivalents were $0.7 million on December 31, 2006. Working capital was $13.3 million on December 31, 2006. Cash and cash equivalents were $4.0 million on December 31, 2005. Working capital was $35.4 million on December 31, 2005. During the twelve months ended December 31, 2006, we made net borrowings of $128 million under our credit facilities and used $31.5 million of cash to acquire selected assets of five radio stations, three Internet businesses and two magazine businesses.

Net cash provided by operating activities decreased by $2.2 million to $36.7 million for the year ended December 31, 2006 compared to $38.9 million in 2005. The decrease is primarily due to higher cash paid for interest expense of $6.0 million that was offset by an increase in net income from continuing operations of $3.5 million that includes non-cash gains recognized on exchanges of radio stations of $18.6 million and non-cash stock based compensation expense of $4.3 million that were partially offset by an increase in deferred income taxes of $4.4 million and a decrease in deferred revenue of $3.9 million.



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Net cash used by investing activities decreased to $50.6 million for the year ended December 31, 2006, compared to $83.4 million in 2005. The decrease is primarily due to lower cash outlays for acquisition activity, $31.5 million of cash used to purchase selected assets of five radio stations, three Internet businesses and two magazine businesses during the twelve months ended December 31, 2006, compared to $60.2 million used to purchase selected assets of seven radio stations and one Internet business in the prior year.

Net cash from financing activities decreased $41.3 million for the year ended December 31, 2006. The decrease is primarily due to cash used for the redemption of our 9% notes of $98.3 million which included a premium, the payment of a special cash dividend of $14.6 million, and treasury stock repurchases of $20.7 million offset by net borrowings of $129.0 million.

*Credit Facilities.* Our wholly-owned subsidiary, Salem Holding, is the borrower under our credit facilities. On July 7, 2005, the credit facilities were amended to, among other things, add a $150.0 million delayed-draw term loan C facility ( term loan C facility ). The credit facilities were subsequently amended on June 9, 2006 to increase the loan commitments under the term loan C facility by $15.0 million; allow for the payment of dividends of up to $5.0 million per year and payment of an additional $30.0 million in dividends during the life of the credit facility; allow for the payment of dividends and the repurchase of stock, in addition to the amounts repurchased prior to the amendment, of an additional $50.0 million when total leverage is greater than 4.00 to 1.00 but less than 5.50 to 1.00 and up to $15.0 million when total leverage is greater than 5.50 to 1.00.

The credit facilities, as amended, 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. As of December 31, 2006, the borrowing capacity and aggregate commitments were $75.0 million under our revolving credit facility, $73.1 million under our term loan B facility and $165.0 million under our term loan C facility. The amount we can borrow, however, is subject to certain restrictions as described below. As of December 31, 2006, we could borrow $51.9 million under our credit facilities.

On December 31, 2006, $73.1 million was outstanding under the term loan B facility, $165.0 million was outstanding under the term loan C facility and $19.1 million was outstanding under our revolving credit facility. The borrowing capacity under the revolving credit facility steps down in three 10% increments commencing June 30, 2007, and matures on March 25, 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 25, 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 December 31, 2006, the blended interest rate on amounts outstanding under the credit facilities was 6.95%.

The maximum amount that Salem Holding may borrow under our credit facilities is limited by a ratio of our consolidated existing 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 December 31, 2006. 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 December 31, 2006, on a pro forma basis, was 5.88 to 1.

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 June 30, 2009 increasing in increments to 2.5 to 1 after June 30, 2009), 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, which will decline periodically until December 31, 2008, 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.

On October 18, 2006, the company purchased two interest rate caps for $0.1 million to mitigate exposure to rising interest rates based on LIBOR. 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%.

As of December 31, 2006, 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. As collateral for the Swingline, the company pledged its corporate office building. Amounts outstanding under the Swingline bear interest at a rate based on the bank s prime rate. As of December 31, 2006, $1.2 million was outstanding under the Swingline bearing interest at 8.25%.

As of December 31, 2006, 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 December 31, 2006, we were and remain in compliance with all of the covenants under the indenture for the 7¾% Notes.

A summary of long-term debt obligations is as follows:

| Summary of Long-Term Debt Obligations | As of December 31, 2005 | | As of December 31, 2006 | |
|---|---|---|---|---|
| | *(Dollars in thousands)* | | | |
| Term loan B | $ | 73,875 | $ | 73,125 |
| Term loan C | | 50,000 | | 165,000 |
| Revolving line of credit under credit facility | | 6,600 | | 19,100 |
| Swingline credit facility | | | | 1,241 |

| | | | | |
|---|---|---|---|---|
| 9% senior subordinated notes due 2011 (1) | | 96,664 | | |
| 7¾% senior subordinated notes due 2010 | | 100,000 | | 100,000 |
| Fair market value of interest rate swap agreement | | 215 | | |
| Capital leases and other loans | | 142 | | 2,560 |
| | $ | 327,496 | $ | 361,026 |
| Less current portion | | 811 | | 2,048 |
| | $ | 326,685 | $ | 358,978 |

(1) Includes $2,633 as of December 31, 2005 of fair value adjustments related to terminated interest rate swaps. The principal amount outstanding was $94,031 as of December 31, 2005.

**OFF-BALANCE SHEET ARRANGEMENTS**

At December 31, 2006 and 2005, Salem did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, Salem is not materially exposed to any financing, liquidity, market or credit risk that could arise if Salem had engaged in such relationships.

**CONTRACTUAL OBLIGATIONS**

The following table summarizes our aggregate contractual obligations at December 31, 2006, and the estimated timing and effect that such obligations are expected to have on our liquidity and cash flow in future periods

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 1-3 years | 3-5 years | More Than 5 years |
| | | *(Dollars in thousands)* | | | |
| Long-term debt, including current portion | $ 358,466 | $ 1,991 | $ 20,600 | $ 335,875 | $ |
| Interest payments on long-term debt (1) | 58,875 | 17,942 | 34,603 | 6,330 | |
| Capital lease obligations and other loans | 2,560 | 57 | 2,493 | 10 | |
| Operating leases | 77,280 | 9,920 | 17,246 | 14,408 | 35,706 |
| Total contractual cash obligations | $ 497,181 | $ 29,910 | $ 74,942 | $ 356,623 | $ 35,706 |

(1)

Interest payments on long-term debt are based on the outstanding debt and respective interest rates with interest rates on variable-rate debt held constant through maturity at the December 31, 2006 rates. Interest ultimately paid on these obligations may differ based on changes in interest rates for variable-rate debt, as well as any potential future refinancing. See Note 4 to the accompanying consolidated financial statements for further details.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

**DERIVATIVE INSTRUMENTS**

We are exposed to fluctuations in interest rates. Salem actively monitors these fluctuations and uses derivative instruments from time to time to manage the related risk. In accordance with our risk management strategy, Salem uses derivative instruments only for the purpose of managing risk associated with an asset, liability, committed transaction, or probable forecasted transaction that is identified by management. 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.

During 2004 and through February 18, 2005, we had an interest rate swap agreement with a notional principal amount of $66.0 million. This agreement related to its $94.4 million 9% Notes. This agreement was scheduled to expire in 2011 when the 9% Notes were to mature, and effectively swapped the 9.0% fixed interest rate on $66.0 million of the 9% Notes for a floating rate equal to the LIBOR rate plus 3.09%. On February 18, 2005, we sold our entire interest in this swap and received a payment of approximately $3.7 million, which was amortized as a reduction of interest expense over the remaining life of the 9% Notes. On July 6, 2006, we



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completed the redemption of the remainder of our outstanding 9% senior subordinated notes. As a result of the redemption, we wrote off the remaining balance of the buyout premium of approximately $2.7 million as a reduction of the loss on the early redemption of long term debt. Interest expense for the year ended December 31, 2006, was reduced by approximately $0.3 million related to the amortization of the buyout premium received. —

During 2004, we also had a second interest rate swap agreement with a notional principal amount of $24.0 million. This agreement also related to its 9% Notes. This agreement was to expire in 2011 when the 9% Notes were to mature, and effectively swapped the 9.0% fixed interest rate on $24.0 million of the 9% Notes for a floating rate equal to the LIBOR rate plus 4.86%. On August 20, 2004, we sold our interest in $14.0 million of this swap. As a result of this transaction, we paid and capitalized $0.3 million in buyout premium, which was amortized into interest expense over the remaining life of the 9% Notes. On October 22, 2004, we sold our remaining $10.0 million interest in this swap. As a result of this second transaction, we paid and capitalized approximately $110,000 in buyout premium, which was amortized into interest expense over the remaining life of the 9% Notes. On July 6, 2006, we completed the redemption of the remainder of our outstanding 9% Notes. As a result of this redemption, we recorded a loss on the swap of approximately $0.3 million which is included in the loss on early redemption of long-term debt. We recognized approximately $33,000 in interest expense for twelve months ended December 31, 2006 related to the amortization of capitalized buyout premium.

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 year ended December 31, 2006, was reduced by approximately $69,000 as a result of the difference between the interest rates. As of December 31, 2006, we recorded an asset for the fair value of the interest swap of approximately $50,000. This amount, net of income tax benefits of approximately $20,000, is reflected in other comprehensive income, 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 year ended December 31, 2006, was reduced by approximately $114,000 as a result of the difference between the interest rates. As of December 31, 2006, we recorded an asset for the fair value of the interest swap of approximately $0.5 million. This amount, net of income tax benefits of approximately $0.2 million, is reflected in other comprehensive income, as 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 year ended December 31, 2006, was reduced by approximately $139,000 as a result of the difference between the interest rates. As of December 31, 2006, we recorded an asset for the fair value of the interest swap of approximately $0.8 million. This amount, net of income taxes of approximately $0.3 million, is reflected in other comprehensive income, 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 October 18, 2006, the Company purchased two interest rate caps for $0.1 million to mitigate exposure to rising interest rates based on LIBOR. 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. As of December 31, 2006, interest expense of $53,000 was booked related to our 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 December 31, 2006, we had borrowed $257.2 million under our credit facilities and Swingline. As of December 31, 2006, we could borrow up to an additional $51.9 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 December 31, 2006, the blended interest rate on amounts outstanding under the credit facilities was 6.95%. At December 31, 2006 a hypothetical 100 basis point increase in the prime rate or LIBOR, as applicable, would result in additional interest expense of $1.7 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 7¾% Notes as of December 31, 2006, with an aggregate fair value of $101.4 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 $98.1 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 $104.9 million.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

## INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Salem Communications Corporation

We have audited the accompanying consolidated balance sheets of Salem Communications Corporation as of December 31, 2005 and 2006, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of Salem Communications Corporation s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Salem Communications Corporation at December 31, 2005 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, on January 1, 2006 Salem Communications Corporation changed its method of accounting for share-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004) and its method of accounting for exchanges of non-monetary assets in accordance with Statement of Financial Accounting Standards No. 153.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Salem Communications Corporation s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Los Angeles, California

March 15, 2007

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**SALEM COMMUNICATIONS CORPORATION**
**CONSOLIDATED BALANCE SHEETS**
**(Dollars in thousands, except share and per share data)**

| | December 31, 2005 | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 3,979 | **$ 710** |
| Trade accounts receivable (less allowance for doubtful accounts of $7,215 in 2005 and $7,606 in 2006) | 30,953 | **31,984** |
| Other receivables | 1,579 | **551** |
| Prepaid expenses | 2,468 | **2,330** |
| Deferred income taxes | 4,614 | **5,020** |
| Assets of discontinued operations | 12,456 | **-** |
| Total current assets | 56,049 | **40,595** |
| Property, plant and equipment, net | 116,245 | **128,713** |
| Broadcast licenses | 443,092 | **476,544** |
| Goodwill | 16,803 | **20,606** |
| Other indefinite-lived intangible assets | - | **2,892** |
| Amortizable intangible assets (net of accumulated amortization of $7,726 in 2005 and $10,846 in 2006) | 3,244 | **8,368** |
| Bond issue costs | 2,742 | **593** |
| Bank loan fees | 3,709 | **2,996** |
| Fair value of interest rate swap agreements | 743 | **1,290** |
| Other assets | 3,303 | **3,667** |
| Total assets | $ 645,930 | **$ 686,264** |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 448 | **$ 3,421** |

| | | |
|---|---|---|
| Accrued expenses | 5,606 | **6,446** |
| Accrued compensation and related expenses | 6,461 | **7,033** |
| Accrued interest | 5,429 | **4,275** |
| Deferred revenue | 1,903 | **4,050** |
| Current portion of long-term debt and capital lease obligations | 811 | **2,048** |
| Income tax payable | - | **22** |
| Total current liabilities | 20,658 | **27,295** |
| Long-term debt and capital lease obligations, less current portion | 326,685 | **358,978** |
| Deferred income taxes | 40,810 | **53,935** |
| Deferred revenue | 7,304 | **7,063** |
| Other liabilities | 1,355 | **1,277** |
| Total liabilities | 396,812 | **448,548** |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Class A common stock, $0.01 par value; authorized 80,000,000 shares; 20,410,992 issued and 19,771,199 outstanding shares in 2005; 20,424,242 issued and 18,293,824 outstanding in 2006 | 204 | **204** |
| Class B common stock, $0.01 par value; authorized 20,000,000 shares; 5,553,696 issued and outstanding shares in 2005 and 2006 | 56 | **56** |
| Additional paid-in capital | 217,036 | **221,466** |
| Retained earnings | 43,043 | **47,433** |
| Treasury stock, at cost (639,793 shares and 2,130,418 shares as of December 31, 2005 and 2006, respectively) | (11,539) | **(32,218)** |
| Accumulated other comprehensive income | 318 | **775** |
| Total stockholders equity | 249,118 | **237,716** |
| Total liabilities and stockholders equity | $ 645,930 | **$ 686,264** |

See accompanying notes

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2005 | **2006** |
| Net broadcasting revenue | $ 184,296 | $ 198,852 | **$ 208,400** |
| Non-broadcast revenue | 9,342 | 10,790 | **19,369** |
| Total revenue | 193,638 | 209,642 | **227,769** |
| Operating expenses: | | | |
| Broadcasting operating expenses exclusive of depreciation and amortization shown below (including $1,101, $1,115 and $1,117 for the years ended December 31, 2004, 2005 and 2006, respectively, paid to related parties) | 112,334 | 121,462 | **131,117** |
| Cost of denied / abandoned tower site and license upgrade | 746 | | |
| Non-broadcast operating expenses exclusive of depreciation and amortization shown below | 8,600 | 9,889 | **18,172** |
| Legal settlement | | 650 | |
| Corporate expenses exclusive of depreciation and amortization shown below (including $342, $256 and $235 for the years ended December 31, 2004, 2005 and 2006, respectively, paid to related parties) | 17,480 | 19,607 | **24,043** |
| Depreciation (including $414, $394 and $862 for the years ended December 31, 2004, 2005 and 2006, respectively, for non-broadcast businesses) | 10,538 | 11,557 | **12,073** |
| Amortization (including $620, $518 and $2,405 for the years ended December 31, 2004, 2005 and 2006, respectively, for non-broadcast businesses) | 1,533 | 1,460 | **3,120** |
| (Gain) loss on disposal of assets | 3,217 | 527 | **(18,647)** |
| Total operating expenses | 154,448 | 165,152 | **169,878** |
| Operating income from continuing operations | 39,190 | 44,490 | **57,891** |
| Other income (expense): | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Interest income | | 171 | | 207 | | **210** |
| Interest expense | | (19,931) | | (22,559) | | **(26,342)** |
| Loss on early redemption of long-term debt | | (6,588) | | (24) | | **(3,625)** |
| Other expense, net | | (116) | | (506) | | **(420)** |
| Income from continuing operations before income taxes | | 12,726 | | 21,608 | | **27,714** |
| Provision for income taxes | | 4,859 | | 8,570 | | **11,167** |
| Income from continuing operations | | 7,867 | | 13,038 | | **16,547** |
| Income (loss) from discontinued operations, net of tax | | (534) | | (376) | | **2,452** |
| Net income | $ | 7,333 | $ | 12,662 | **$** | **18,999** |
| Other comprehensive income, net of tax | | | | 318 | | **457** |
| Comprehensive income | $ | 7,333 | $ | 12,980 | **$** | **19,456** |

See accompanying notes

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2005 | **2006** |
| Basic earnings (loss) per share data: | | | |
| Earnings per share from continuing operations | $ 0.31 | $ 0.51 | **$** 0.68 |
| Income (loss) per share from discontinued operations | (0.02) | (0.01) | 0.10 |
| Basic earnings per share | 0.29 | 0.49 | 0.78 |
| Diluted earnings (loss) per share data: | | | |
| Earnings per share from continuing operations | $ 0.31 | $ 0.51 | **$** 0.68 |
| Income (loss) from discontinued operations | (0.02) | (0.01) | 0.10 |
| Diluted earnings per share | 0.29 | 0.49 | 0.78 |
| Basic weighted average shares outstanding | 25,220,678 | 25,735,641 | **24,215,867** |
| Diluted weighted average shares outstanding | 25,371,649 | 25,794,875 | **24,223,751** |

See accompanying notes

**SALEM COMMUNICATIONS CORPORATION**
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**
**(Dollars in thousands, except share data)**

| | Class A Common Stock | | Class B Common Stock | | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | | |
| Stockholders equity, January 1, 2004 | 17,956,567 | $180 | 5,553,696 | $56 | $148,538 | $23,048 | | | $171,822 |
| Public issuance of class A common stock | 2,325,000 | 23 | | | 65,691 | | | | 65,714 |
| Options exercised | 127,175 | 1 | | | 2,272 | | | | 2,273 |
| Tax benefit related to stock options exercised | | | | | 495 | | | | 495 |
| Net income | | | | | | 7,333 | | | 7,333 |
| Stockholders equity, December 31, 2004 | 20,408,742 | 204 | 5,553,696 | 56 | 216,996 | 30,381 | | | 247,637 |
| Options exercised | 2,250 | | | | 33 | | | | 33 |
| Tax benefit related to stock options exercised | | | | | 7 | | | | 7 |
| Class A common stock shares repurchased | | | | | | | (11,539) | | (11,539) |
| Net unrealized income on interest rate swap agreement | | | | | | | | 318 | 318 |
| Net income | | | | | | 12,662 | | | 12,662 |
| Stockholders' equity, December 31, 2005 | 20,410,992 | 204 | 5,553,696 | 56 | 217,036 | 43,043 | (11,539) | 318 | 249,118 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Options exercised | 13,250 | | | | 95 | | | | 95 |
| Tax benefit related to stock options exercised | | | | | 1 | | | | 1 |
| Class A common stock shares repurchased | | | | | | | (20,679) | | (20,679) |
| Dividends | | | | | | (14,609) | | | (14,609) |
| Stock based compensation | | | | | 4,334 | | | | 4,334 |
| Net unrealized income on interest rate swap agreement | | | | | | | | 457 | 457 |
| Net income | | | | | | 18,999 | | | 18,999 |
| **Stockholders' equity, December 31, 2006** | **20,424,242** | **204** | **5,553,696** | **56** | **221,466** | **47,433** | **(32,218)** | **775** | **237,716** |

See accompanying notes

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2005 | **2006** |
| **OPERATING ACTIVITIES** | | | |
| Income from continuing operations | $ 7,867 | $ 13,038 | **$ 16,547** |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | | |
| Non-cash stock-based compensation | | | **4,334** |
| Depreciation and amortization | 12,071 | 13,017 | **15,193** |
| Amortization of bond issue costs and bank loan fees | 1,486 | 1,470 | **1,360** |
| Amortization and accretion of financing items | | (687) | **(166)** |
| Provision for bad debts | 3,821 | 2,793 | **3,566** |
| Deferred income taxes | 3,787 | 8,024 | **12,414** |
| (Gain) loss on disposal of assets | 3,217 | 527 | **(18,647)** |
| Loss on early redemption of debt | 6,588 | 24 | **3,625** |
| Costs of denied tower site and license upgrade | 746 | | |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (1,847) | (4,211) | **(3,488)** |
| Prepaid expenses and other current assets | 1,189 | (335) | **154** |
| Accounts payable and accrued expenses | (279) | 446 | **1,256** |
| Deferred revenue | 131 | 4,441 | **569** |
| Other liabilities | 156 | 356 | **(78)** |
| Income taxes payable | | | **22** |
| Net cash provided by continuing operating activities | 38,933 | 38,903 | **36,661** |
| **INVESTING ACTIVITIES** | | | |
| Capital expenditures | (17,667) | (22,222) | **(21,122)** |
| Deposits on radio station acquisitions | (425) | 670 | |
| Purchases of radio station assets | (26,460) | (53,249) | **(20,229)** |
| Purchases of Internet and magazine businesses | | (6,940) | **(11,246)** |
| Proceeds from sale of property, plant and equipment and broadcast licenses | 1 | 80 | **2,400** |
| Other | 394 | (1,761) | **(364)** |

| | | | |
|---|---|---|---|
| Net cash used in investing activities | (44,157) | (83,422) | **(50,561)** |
| **FINANCING ACTIVITIES** | | | |
| Net proceeds from issuance of Class A common stock | 65,714 | | |
| Repurchase of Class A common stock | | (11,539) | **(20,679)** |
| Payments to redeem 9% Notes | (55,630) | | **(94,031)** |
| Proceeds from borrowings under credit facilities | 24,000 | 87,750 | **156,000** |
| Payments of long-term debt and notes payable | (20,000) | (41,275) | **(28,009)** |
| Proceeds from exercise of stock options | 2,273 | 33 | **95** |
| Tax benefit related to stock options exercised | 495 | 7 | **1** |
| Payment of cash dividend on common stock | | | **(14,609)** |
| Issuance of loans and capital lease obligations | 24 | 84 | |
| Payments on capital lease obligations | (18) | (9) | **(26)** |
| Payments for interest rate swap | (440) | (339) | |
| Payments of costs related to bank credit facility and debt financing | (497) | (870) | **(273)** |
| Proceeds from interest rate swap termination | | 3,730 | |
| Payment of bond premium | (4,998) | (24) | **(4,231)** |
| Other | | | **1,989** |
| Net cash provided by (used in) financing activities | 10,923 | 37,548 | **(3,773)** |
| **CASH FLOWS FROM DISCONTINUED OPERATIONS** | | | |
| Operating cash flows | (663) | (123) | **(3,251)** |
| Investing cash flows | 338 | 79 | **17,655** |
| Total cash inflow (outflow) form discontinued operations | (325) | (44) | **14,404** |
| Net increase (decrease) in cash and cash equivalents | 5,374 | (7,015) | **(3,269)** |
| Cash and cash equivalents at beginning of period | 5,620 | 10,994 | **3,979** |
| Cash and cash equivalents at end of period | $ 10,994 | $ 3,979 | **$ 710** |

See accompanying notes

**SALEM COMMUNICATIONS CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**

**(Dollars in thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2005 | **2006** |
| **Supplemental disclosures of cash flow information:** | | | |
| Cash paid during the period for: | | | |
| Interest | $ 23,627 | $ 21,447 | **$ 27,496** |
| Income taxes | 300 | 341 | **256** |

See accompanying notes

**SALEM COMMUNICATIONS CORPORATION**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

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

The Company is a holding company with substantially no assets, operations or cash flows other than its investments in subsidiaries. The Company, excluding its subsidiaries, is herein referred to as Parent. In May 2000, the Company formed two new wholly-owned subsidiaries, Salem Communications Holding Corporation ( HoldCo ) and Salem Communications Acquisition Corporation ( AcquisitionCo ), each a Delaware corporation. HoldCo is the issuer of the 7¾% Senior Subordinated Notes due 2010 ( 7¾% Notes ). HoldCo is a holding company with substantially no assets, operations or cash flows other than its investments in subsidiaries. In July 2000, the Company formed SCA License Corporation ( SCA ), a Delaware corporation. HoldCo and AcquisitionCo are direct subsidiaries of the Company; SCA is a wholly-owned subsidiary of AcquisitionCo. Parent, AcquisitionCo and all of its subsidiaries and all of the subsidiaries of HoldCo are Guarantors of the 7¾% Notes discussed in Note 4. The Guarantors (i) are wholly-owned subsidiaries of the Company, (ii) comprise substantially all the Company s direct and indirect subsidiaries and (iii) have fully and unconditionally guaranteed on a joint and several basis and the 7¾% Notes. SCA owns the assets of eight radio stations as of December 31, 2006. See Note 13 for certain consolidating information with respect to the Company.

### Description of Business

Salem is a domestic U.S. radio broadcast company, which has traditionally provided talk and music programming targeted at audiences interested in Christian and family issues. Salem operated 104 and 97 radio stations across the United States at December 31, 2005 and 2006, respectively. The Company also owns and operates Salem Radio Network® ( SRN ), SRN News Network ( SNN ), Salem Music Network ( SMN ), Reach Satellite Network ( RSN ), Sa Radio Representatives ( SRR ) and Vista Radio Representatives ( VRR ). SRN, SNN, SMN and RSN are radio networks, which produce and distribute talk, news and music programming to radio stations in the U.S., including some of Salem s stations. SRR and VRR sell commercial air time to national advertisers for Salem s radio stations and networks, and for independent radio station affiliates.

Additionally, Salem also owns and operates Internet businesses, including Salem Web Network ( SWN ) and Townhall.com, and publishing businesses including Salem Publishing and Xulon Press. SWN and Townhall.com provide Christian and conservative editorial content on the Internet as well as on-demand audio streaming and related services. Salem Publishing and Xulon publish magazines and books that follow the Christian music industry and that serve the Christian audience. The revenue and related operating expenses of these businesses are reported as non-broadcast on the consolidated Statements of Operations.

### Cash and Cash Equivalents

The Company considers all highly liquid debt instruments, purchased with an initial maturity of three months or less, to be cash equivalents. The carrying value of the Company s cash equivalents approximated fair value at each balance sheet date.

### Revenue Recognition

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

Revenue from radio programs and commercial advertising is recognized when broadcast. Salem s broadcasting customers principally include not-for-profit charitable organizations and commercial advertisers.

Revenue from the sale of products and services from the Company s non-broadcast businesses is recognized when the products are shipped and the services are rendered. Revenue from the sale of advertising in Salem Publishing s publications is recognized upon publication. Revenue from the sale of subscriptions to Salem Publishing s publications is recognized over the life of the subscription. Revenues from book sales are recorded by Xulon Press 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. Barter advertising revenue included in broadcasting revenue for the years ended December 31, 2004, 2005 and 2006 was approximately $5.4 million, $5.5 million and $5.4 million, respectively, and barter expenses were approximately the same as barter revenue for each period. The Company records its broadcast advertising provided in exchange for goods and services as broadcasting revenue and the goods or services received in exchange for such advertising as broadcasting operating expenses.

**Accounting For Stock Based Compensation**

The Company has one employee compensation plan, described more fully in Note 7. Stock Option Plan. Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), Share-Based Payment. SFAS No. 123(R) requires employee equity awards to be accounted for under the fair value method. Accordingly, share-based compensation is measured at the grant date, based on the fair value of the award. Prior to January 1, 2006, the Company accounted for awards granted under its equity incentive plans using the intrinsic value method prescribed by Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, and provided the required pro forma disclosures prescribed by SFAS No. 123, Accounting for Stock-Based Compensation, as amended. The exercise price of options is equal to the market price of Salem Communications common stock on the date of grant. Additionally, the stock purchase plan was deemed non-compensatory under APB No. 25. Accordingly, no share-based compensation, other than insignificant amounts of acquisition-related compensation, was recognized on the consolidated financial statements prior to 2006.

Under the modified prospective method of adoption for SFAS No. 123(R), the compensation cost recognized by the Company beginning in 2006 includes (a) compensation cost for all equity incentive awards granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all equity incentive awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company uses the straight-line attribution method to recognize share-based compensation costs over the service period of the award. Upon exercise, cancellation, forfeiture, or expiration of stock options, or upon vesting or forfeiture of restricted stock units, deferred tax assets for options and restricted stock units with multiple vesting dates are eliminated for each vesting period on a first-in, first-out basis as if each vesting period was a separate award. To calculate the excess tax benefits available as of the date of adoption for use in offsetting future tax shortfalls, the Company followed the alternative transition method discussed in Financial Accounting Standards Board ( FASB ) Staff Position No. 123(R)-3.

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

From time to time the Company undertakes projects to upgrade its radio station technical facilities and/or FCC licenses. The Company s policy is to capitalize costs up to the point where the project is complete, at which point the Company transfers the costs to the appropriate fixed asset and/or intangible asset categories. In certain cases where a project s completion is contingent upon FCC or other regulatory approval, the Company will 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. If the required approval is not considered probable, the Company will write-off the capitalized costs of the project. The write-offs are included in Cost of denied / abandoned tower site and license upgrade in the Company s Consolidated Statements of Operations.

**RECENT ACCOUNTING PRONOUNCEMENTS**

***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 is effective beginning

January 1, 2008. The Company believes that the adoption of SFAS No. 159 will not have a material impact on the Company s results of operations, cash flows or financial position.

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

On September 15, 2006, the FASB issued SFAS No. 157, Fair Value Measurements 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. The Company believes that the adoption of SFAS No. 157 will not have a material impact on the Company s results of operations, cash flows or financial position.

***FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109)***

In July 2006, the FASB issued FASB Interpretation ( FIN ) No. 48, Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109) . FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective beginning January 1, 2007, and the cumulative effect adjustment, if any, will be recorded in the first quarter of 2007. The Company continues to evaluate the impact of FIN No. 48 on its consolidated financial statements. At this time, the Company does not know what the impact will be upon the adoption of this standard.

***Statement of Financial Accounting Standards No. 153***

In December 2004, the FASB issued SFAS No. 153, Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29, which addresses the measurement of exchanges of non-monetary assets and eliminates the exception from fair value accounting for non-monetary exchanges of similar productive assets and replaces it with an exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a non-monetary exchange has commercial substance if the future cash flows of an entity are expected to change significantly as a result of the exchange. This statement was effective for the Company beginning in the first quarter of fiscal year 2006 and had a significant impact on the Company s results of operations, cash flows and financial position. As a result of this accounting pronouncement, the Company recognized a net gain on exchanges of radio stations of $18.7 million for the year ended December 31, 2006 which is reported in discontinued operations and in (gain) loss on disposal of assets.

***Staff Accounting Bulletin No. 108***

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin No. 108, ( SAB 108 ). The interpretations in SAB 108 are being issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. SAB 108 is effective for the first interim period of the first fiscal year ending after November 15, 2006. SAB 108 was effective for the Company beginning in 2006 and there were no adjustments to opening retained earnings resulting from its application.

**Discontinued Operations**

The following table sets forth the components of income (loss) from discontinued operations, net of tax, for the years ended December 31, 2004, 2005 and 2006 (dollars in thousands).

| | Year Ended December 31, | | |
| --- | --- | --- | --- |
| | 2004 | 2005 | **2006** |
| Operating loss | $ (875) | $ (897) | **$ (327)** |
| Gain on sale or exchange of station | | 325 | **4,332** |
| Gain (loss) from discontinued operations, net of tax | (875) | (572) | **4,005** |
| Provision (benefit) for income taxes | (341) | (196) | **1,553** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Income (loss) from discontinued operations, net of tax | $ | (534) | $ | (376) | $ | **2,452** |

Details of these transactions are as follows:

On February 10, 2006, the Company exchanged radio stations WTSJ-AM, Cincinnati, Ohio, and WBOB-AM, Cincinnati, Ohio and $6.7 million in cash for selected assets of radio station WLQV-AM, Detroit, Michigan. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WTSJ-AM and WBOB-AM as discontinued operations through the date of the sale. All prior periods have been revised to reflect the operating results of these stations as discontinued operations to conform to the current period presentation. The exchange was accounted for under SFAS No. 153, Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29, and resulted in a pre-tax gain on the exchange of $0.7 million.

On July 17, 2006, the Company completed the sale of radio station WBTK-AM, Richmond, Virginia, for $1.5 million resulting in a pre-tax gain of $0.6 million. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WBTK-AM as a discontinued operation. All prior periods have been revised to reflect the operating results of this station as a discontinued operation to conform to the current period presentation.

On September 18, 2006, the Company completed the sale of radio station WBGB-FM, Jacksonville, Florida for $7.6 million resulting in a pre-tax gain of $0.8 million. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WBGB-FM as a discontinued operation. All prior periods have been revised to reflect the operating results of this station as a discontinued operation to conform to the current period presentation.

On December 1, 2006, the Company completed the sale of radio stations WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida for $2.8 million resulting in a pre-tax gain of $0.1 million. The assets were sold to Chesapeake-Portsmouth Broadcasting Corporation ( Chesapeake-Portsmouth ). Chesapeake-Portsmouth is a company controlled by Nancy Epperson, wife of Salem's Chairman of the Board Stuart W. Epperson and sister of Salem s CEO Edward G. Atsinger III. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida as discontinued operations. All prior periods have been revised to reflect the operating results of these stations as discontinued operations to conform to the current period presentation.

On December 22, 2006, the Company completed the sale of radio station WITH-AM, Baltimore, Maryland for $3.0 million resulting in a pre-tax gain of $2.2 million. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WITH-AM as a discontinued operation. All prior periods have been revised to reflect the operating results of this station as a discontinued operation to conform to the current period presentation.

**Property, Plant and Equipment**

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives as follows:

| Category | Life |
|---|---|
| Buildings | 40 years |

| | |
|---|---|
| Office furnishings and equipment | 5-10 years |
| Antennae, towers and transmitting equipment | 20 years |
| Studio and Production equipment | 10 years |
| Computer software | 3 years |
| Record and tape libraries | 5 years |
| Automobiles | 5 years |
| Leasehold improvements | Lesser of 15 years or life of lease |

The carrying value of property, plant and equipment is evaluated periodically in relation to the operating performance and anticipated future cash flows of the underlying radio stations and businesses for indicators of impairment. When indicators of impairment are present and the undiscounted cash flows estimated to be generated from these assets are less than the carrying value of these assets an adjustment to reduce the carrying value to the fair market value of the assets is recorded, if necessary. No adjustments to the carrying amounts of property, plant and equipment have been made during the years ended December 31, 2004, 2005 and 2006.

**Amortizable Intangible Assets**

Intangible assets acquired in conjunction with the acquisition of various radio stations and non-broadcast businesses are being amortized over the following estimated useful lives using the straight-line method:

| Category | Life |
|---|---|
| Customer lists and contracts | Lesser of 5 years or life of contract |
| Favorable and assigned leases | Life of the lease |
| Other | 5-10 years |

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

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

| | As of December 31, 2005 | | |
|---|---|---|---|
| | Cost | Accumulated Amortization | **Net** |
| | *(Dollars in thousands)* | | |
| Customer lists and contracts | $ 5,419 | $ (4,062) | $ 1,357 |
| Domain and brand names | 1,878 | (766) | 1,112 |
| Favorable and assigned leases | 1,581 | (1,059) | 522 |
| Other amortizable intangible assets | 2,092 | (1,839) | 253 |
| | $ 10,970 | $ (7,726) | $ 3,244 |

Based on the amortizable intangible assets as of December 31, 2006, the Company estimates amortization expense for the next five years to be as follows:

| Year Ending December 31, | Amortization Expense |
|---|---|

| | (Dollars in thousands) |
|---|---|
| 2007 | $ 2,922 |
| 2008 | 2,467 |
| 2009 | 1,215 |
| 2010 | 775 |
| 2011 | 313 |
| Thereafter | 676 |
| Total | $ 8,368 |

The carrying value of intangibles is evaluated periodically in relation to the operating performance and anticipated future cash flows of the underlying radio stations and businesses for indicators of impairment. When indicators of impairment are present and the undiscounted cash flows estimated to be generated from these assets are less than the carrying amounts of these assets, an adjustment to reduce the carrying value to the fair market value of these assets is recorded, if necessary. No adjustments to the carrying amounts of intangible assets have been made during the years ended December 31, 2004, 2005 and 2006.

**Goodwill and Indefinite Lived Intangible Assets**

The Company accounts for goodwill and other indefinite lived intangible assets in accordance with 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 when events indicate that impairment may exist. The Company completed its annual impairment tests in the fourth quarter of 2006 The Company estimates fair value of its indefinite lived intangibles using a combination of market analysis, review of appraisals and cash flow analysis. No adjustments to the carrying value of goodwill and other indefinite long-lived assets were necessary based on our review and evaluations.

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

In preparation for the implementation of a fixed asset management and tracking system, Salem conducted a physical inventory of its property, plant and equipment during 2004. Based on the results, the Company wrote-off certain assets, with a net book value of approximately $3.1 million, charged to loss on disposal of assets during the third and fourth quarter of 2004. Additionally, the loss during the year ended December 31, 2004, includes $0.2 million from the disposition of certain studio and production equipment being sold in connection with the early termination of a lease with a related party. Loss on disposal of assets of $0.5 million for the year ended December 31, 2005 was primarily due to the write-off of various fixed assets and equipment. Gain on disposal of assets of $18.6 million for the year ended December 31, 2006 was primarily due to the gains recognized on various exchange transactions accounted for under SFAS No. 153 as explained in Note 2.

**Leases**

At the time a lease is entered, the Company determines the classification of the lease as either a capital or operating lease based on the factors listed in SFAS No. 13 Accounting for Leases . Lease terms generally range from one to ten years with rent expense recorded on a straight line basis for financial reporting purposes.

**Leasehold Improvements**

If, at any time during tenancy, the Company elects to construct or otherwise invest in leasehold improvements to the property, the Company capitalizes the improvements. Leasehold improvements are amortized over the shorter of the useful life of the improvement or the remaining lease term.

**Bond Issue Costs**

Bond issue costs are being amortized over the terms of the 7¾% Notes as an adjustment to interest expense.

**Derivative Instruments**

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

Under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, the accounting for changes in the fair value of a derivative instrument at each new measurement date is dependent upon its intended use. The change in the fair value of a derivative instrument designated as a hedge of the exposure to changes in the fair value of a recognized asset or liability or a firm commitment, referred to as a fair value hedge, is recognized as gain or loss in earnings in the period of the change together with an offsetting gain or loss for the change in fair value of the hedged item attributable to the risk being hedged. The change in the fair value of a derivative instrument designated as a hedge of the exposure 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.

During 2004 and through February 18, 2005, the Company had an interest rate swap agreement with a notional principal amount of $66.0 million related to its $94.4 million 9% Notes. This agreement was scheduled to expire in 2011 when the 9% Notes were to mature, and effectively swapped the 9.0% fixed interest rate on $66.0 million of the 9% Notes for a floating rate equal to the LIBOR rate plus 3.09%. On February 18, 2005, the Company sold its entire interest in this swap and received a payment of approximately $3.7 million, which was amortized as a reduction of interest expense over the remaining life of the 9% Notes. On July 6, 2006, the Company completed the redemption of the remainder of its outstanding 9% senior subordinated notes. As a result of the redemption, the Company wrote off the remaining balance of the buyout premium of approximately $2.7 million as a reduction of the loss on the early redemption of long term debt. Interest expense for the year ended December 31, 2006, was reduced by approximately $0.3 million related to the amortization of the buyout premium received. —

During 2004, the Company also had a second interest rate swap agreement with a notional principal amount of $24.0 million. This agreement also related to the 9% Notes. This agreement was to expire in 2011 when the 9% Notes were to mature, and effectively swapped the 9.0% fixed interest rate on $24.0 million of the 9% Notes for a floating rate equal to the LIBOR rate plus 4.86%. On August 20, 2004, the Company sold its interest in $14.0 million of this swap. As a result of this transaction, the Company paid and capitalized $0.3 million in buyout premium, which was amortized into interest expense over the remaining life of the 9% Notes. On October 22, 2004, the Company sold its remaining $10.0 million interest in this swap. As a result of this second transaction, the Company paid and capitalized approximately $110,000 in buyout premium, which was amortized into interest expense over the remaining life of the 9% Notes. On July 6, 2006, the Company completed the redemption of the remainder of our outstanding 9% Notes. As a result of this redemption, the Company recorded a loss on the swap of approximately $0.3 million which is included in the loss on early redemption of long-term debt. The Company recognized approximately $33,000 in interest expense for twelve months ended December 31, 2006 related to the amortization of capitalized buyout premium.

On April 8, 2005, the Company entered into an interest rate swap arrangement for the notional principal amount of $30.0 million whereby 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 year ended December 31, 2006, was reduced by approximately $69,000 as a result of the difference between the interest rates. As of December 31, 2006, the Company recorded an asset for the fair value of the interest swap of approximately $50,000. This amount, net of income tax benefits of approximately $20,000, is reflected in other comprehensive income, as the Company has designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap was July 1, 2006 and the expiration date is July 1, 2012.

On April 26, 2005, the Company entered into a second interest rate swap arrangement for the notional principal amount of $30.0 million whereby 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 year ended December 31, 2006, was reduced by approximately $114,000 as a result of the difference between the interest rates. As of December 31, 2006, the Company recorded an asset for the fair value of the interest swap of approximately $0.5 million. This amount, net of income tax benefits of approximately $0.2 million, is reflected in other comprehensive income, as the Company has designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap was July 1, 2006 and the expiration date is July 1, 2012.

On 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 year ended December 31, 2006, was reduced by approximately $139,000 as a result of the difference between the interest rates. As of December 31, 2006, the Company recorded an asset for the fair value of the interest swap of approximately $0.8 million. This amount, net of income taxes of approximately $0.3 million, is reflected in other comprehensive income, as the Company has designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap was July 1, 2006 and the expiration date is July 1, 2012.

**Interest Rate Caps**

On October 18, 2006, the Company purchased two interest rate caps for $0.1 million to mitigate exposure to rising interest rates based on LIBOR. 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. For the year ended December 31, 2006, interest expense of $53,000 was recorded related to our interest rate caps.

**Income Taxes**

The Company accounts for income taxes in accordance with the liability method of providing for deferred income taxes. Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements.

**Comprehensive Income**

SFAS No. 130, Reporting Comprehensive Income establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. The Company accounts for changes in the fair value of its interest rate swaps as a component of Other Comprehensive Income.

**Basic and Diluted Net Earnings Per Share**

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

Options to purchase 762,875, 1,924,269 and 2,152,564 shares of Class A common stock were outstanding at December 31, 2004, 2005 and 2006, respectively. Diluted weighted average shares outstanding exclude outstanding stock options whose exercise price is in excess of the average price of the Company s stock price. These options from the respective computations of diluted net income or loss per share because their effect would be anti-dilutive.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2005 | **2006** |
| Weighted average shares | 25,220,678 | 25,735,641 | **24,215,867** |
| Effect of dilutive securities - stock options | 150,971 | 59,234 | **7,884** |
| Weighted average shares adjusted for dilutive securities | 25,371,649 | 25,794,875 | **24,223,751** |

**Segments**

The Company presents its segment information in Note 12. The Company has one reportable operating segment - radio broadcasting. The remaining non-reportable segments consist of our Internet businesses, SWN and Townhall.com and our publishing businesses, Salem Publishing and Xulon Press, which do not meet the reportable segment quantitative thresholds and accordingly are aggregated below as non-broadcast. The radio broadcasting segment also operates various radio networks.

**Concentrations of Business and Credit Risks**

The majority of the Company s operations are conducted in multiple locations across the country. The Company s credit risk is spread across a large number of customers, none of which account for a significant volume of revenue or outstanding receivables. The Company does not normally require collateral on credit sales; however, credit histories are reviewed before extending substantial credit to any customer. The Company establishes an allowance for doubtful accounts based on customers payment history and perceived credit risks. Bad debt expense has been within management s expectations.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas for which management uses estimates are allowance for bad debts, income tax valuation allowance and impairment analysis for intangible assets including broadcast licenses and goodwill as well as other long-lived assets.

**Reclassifications**

Certain reclassifications were made to the prior year financial statements to conform to the current year presentation. These reclassifications include the accounting for WTSJ-AM, Cincinnati, Ohio, WBOB-AM, Cincinnati, Ohio, WBTK-AM, Richmond, Virginia, WITH-AM, Baltimore, Maryland, WBGB-FM, Jacksonville, Florida, WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida as discontinued operations as discussed in Note 2. The accompanying Consolidated Statement of Operations reflect the results of these stations as discontinued operations for the year ended December 31, 2006. All prior periods have been revised to reflect the operating results and net assets of these stations as discontinued operations to conform to the current period presentation.

**NOTE 2. ACQUISITIONS AND DISPOSITIONS OF ASSETS**

During the year ended December 31, 2006, the Company completed the following transactions:

| **Acquisition Date** | **Station(s)** | **Market Served** | | **Acquisition Cost** | **Format Changed** |
|---|---|---|---|---|---|
| | | | | *(Dollars in thousands)* | |
| January 23, 2006 | WTLN-AM | Orlando, FL | $ | 5,497 | No |
| January 23, 2006 | WHIM-AM | Orlando, FL | | 4,503 | No |
| February 3, 2006 | WORL-AM (1) | Orlando, FL | | 3,998 | Yes |
| February 10, 2006 | WLQV-AM (1) | Detroit, MI | | 8,813 | No |
| May 12, 2006 | KKFS-FM (1) | Sacramento, CA | | 21,835 | Yes |
| October 1, 2006 | KORL-AM (1) | Honolulu, HI | | 1,546 | Yes |
| | | | $ | 46,192 | |

(1) Indicates that the station was acquired through an exchange as detailed below.

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

| **Asset** | | Amount |
|---|---|---|
| | | *(Dollars in thousands)* |
| Property and equipment | $ | 4,305 |
| Amortizable intangible assets | | 406 |
| Goodwill | | 211 |
| Broadcast licenses | | 41,270 |

| | |
|---|---|
| $ | 46,192 |

The accompanying Consolidated Balance Sheets includes the acquired assets and liabilities of each acquired entity as of their respective date of acquisition. With the exception of WTLN-AM, WHIM-AM, and KKFS-FM, the results of operations are included in the accompanying Consolidated Statements of Operations as of the date of acquisition. The operating results for both WTLN-AM and WHIM-AM were included in the accompanying Consolidated Statements of Operations beginning on October 1, 2005, the date on which the Company began operating each station under a local marketing agreement ( LMA ) with the seller pending approval of the acquisition by the Federal Communication Commission ( FCC ). The operating results of KKFS-FM were included in the accompanying Consolidated Statements of Operations beginning on July 28, 2005, the date on which the Company began operating the station under an LMA agreement with the seller pending approval of the exchange by the FCC.

On February 3, 2006, the Company exchanged radio station KNIT-AM, Dallas, Texas, for selected assets of radio station WORL-AM, Orlando, Florida. The exchange was accounted for under SFAS No. 153, Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29, which was adopted on January 1, 2006, resulting in a pre-tax gain on the exchange of $3.5 million.

On February 10, 2006, the Company exchanged radio stations WTSJ-AM, Cincinnati, Ohio, and WBOB-AM, Cincinnati, Ohio and $6.7 million in cash for selected assets of radio station WLQV-AM, Detroit, Michigan. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WTSJ-AM and WBOB-AM as discontinued operations. All prior periods have been revised to reflect the operating results of these stations as discontinued operations to conform to the current period presentation. The exchange was accounted for under SFAS No. 153, and resulted in a pre-tax gain on the exchange of $0.7 million.

On May 12, 2006, the Company exchanged radio station KLMG-FM, Sacramento, California, for selected assets of radio station KKFS-FM, Sacramento, California. The exchange was accounted for under SFAS No. 153 and resulted in a pre-tax gain on the exchange of $14.6 million. Additionally, the Company sold radio station KBAA-FM, Sacramento, California, for $0.5 million, resulting in a pre-tax loss of $0.6 million.

On May 31, 2006, the Company sold radio station WCCD-AM in Cleveland, Ohio, for $2.1 million resulting in a pre-tax gain of $1.6 million.

On July 17, 2006, the Company completed the sale radio station WBTK-AM, Richmond, Virginia, for $1.5 million resulting in a pre-tax gain of $0.6 million. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WBTK-AM as a discontinued operation. All prior periods have been revised to reflect the operating results of this station as a discontinued operation to conform to the current period presentation.

On September 18, 2006, the Company completed the sale of radio station WBGB-FM, Jacksonville, Florida for $7.6 million resulting in a pre-tax gain of $0.8 million. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WBGB-FM as a discontinued operation. All prior periods have been revised to reflect the operating results of this station as a discontinued operation to conform to the current period presentation.

On October 1, 2006, the Company exchanged radio station KHCM-AM, Honolulu, Hawaii and $1.0 million in cash for selected assets of radio station KORL-AM, Honolulu, Hawaii. The Company retained the call letters of the station. The exchange was accounted for under SFAS No. 153 and resulted in a pre-tax loss on the exchange of $0.04 million.

On December 1, 2006, the Company completed the sale of radio stations WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida for $2.8 million resulting in a pre-tax gain of $0.1 million. The assets were sold to Chesapeake-Portsmouth Broadcasting Corporation ( Chesapeake-Portsmouth ). Chesapeake-Portsmouth is a company controlled by Nancy Epperson, wife of Salem's Chairman of the Board Stuart W. Epperson and sister of CEO Edward G. Atsinger III. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WJGR-AM, Jacksonville, Florida, WZNZ-AM, Jacksonville, Florida and WZAZ-AM, Jacksonville, Florida as discontinued operations. All prior periods have been revised to reflect the operating results of these stations as discontinued operations to conform to the current period presentation.

On December 22, 2006, the Company completed the sale of radio station WITH-AM, Baltimore, Maryland for $3.0 million resulting in a pre-tax gain of $2.2 million. The accompanying Consolidated Statements of Operations for the year ended December 31, 2006 reflect WITH-AM as a discontinued operation. All prior periods have been revised to reflect the operating results of this station as a discontinued operation to conform to the current period presentation.

**Other Completed Transactions**:

On January 1, 2006, the Company acquired The Singing News, a Christian music publication, and its related operations for $4.4 million, which includes $0.2 million of goodwill and $0.6 million of deferred revenue liabilities assumed.

On February 13, 2006, the Company acquired the Internet website CrossDaily.com and its related operations for $2.3 million, which includes $0.6 million of goodwill.



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On April 28, 2006, the Company acquired the Internet website Townhall.com and its related operations for $4.8 million, upon which a $2.6 million seller financed non-interest bearing note was issued. The purchase price includes $1.3 million of goodwill.

On June 1, 2006, the Company acquired Preaching Magazine and its companion web properties and related operations for $0.3 million, which includes $10,000 of goodwill.

On June 1, 2006, the Company acquired Xulon Press, an on-demand digital publisher of books targeting the Christian audience, and its related operations, for $1.5 million, which includes $0.1 million of goodwill and $0.7 million of deferred revenue liabilities.

The purchase price for these transactions was allocated as follows:

| Asset | | Amount (Dollars in thousands) |
|---|---|---|
| | Property and equipment | $ 391 |
| | Amortizable intangible assets | 7,806 |
| | Goodwill | 2,099 |
| | Mastheads | 2,892 |
| | | $ 13,188 |

**Other Pending Transactions:**

On December 1, 2006, the Company entered an LMA agreement with Good Karma Broadcasting, LLC for WKNR-AM serving the Cleveland, OH market. Good Karma Broadcasting began to operate this station as of the LMA date. The accompanying Consolidated Statement of Operations excludes the operating results of this station as of the LMA date. On February 7, 2007, the Company completed the sale of WKNR-AM to Good Karma for $7.0 million.

During the year ended December 31, 2005, the Company completed the following transactions:

| Acquisition Date | Station(s) | Market Served | Acquisition Cost (Dollars in thousands) | Format Changed |
|---|---|---|---|---|
| January 19, 2005 | KAST-FM | Portland, OR | $ 8,000 | Yes |
| January 31, 2005 | WKAT-AM | Miami, FL | 10,000 | Yes |
| January 31, 2005 | KGBI-FM | Omaha, NE | 10,000 | No |
| March 15, 2005 | WRMR-AM | Cleveland, OH | 10,000 | Yes |
| August 12, 2005 | WGUL-AM and WLSS-AM | Tampa, FL and Sarasota, FL | 8,700 | Yes |
| September 1, 2005 | KCRO-AM | Omaha, NE | 3,150 | No |
| December 7, 2005 | KHLP-AM | Omaha, NE | 900 | No |
| | | | $ 50,750 | |

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

| | | | Amount |
|---|---|---|---|
| | | | *(Dollars in thousands)* |
| **Asset** | | | |
| | Property and equipment | $ | 3,953 |
| | Amortizable intangible assets | | 198 |
| | Goodwill | | 616 |
| | Broadcast licenses | | 45,983 |
| | | $ | 50,750 |

**Other Completed Transactions**:

On January 3, 2005, the Company exchanged radio stations KHNR-AM and KHCM-AM, both in Honolulu, Hawaii, for selected assets of radio station KGMZ-FM, Honolulu, Hawaii. The net carrying amount of the assets exchanged approximated $1.2 million. No gain or loss was recognized by the Company as a result of this exchange.

On February 11, 2005, the Company acquired the Internet website Christianity.com and its related operations for $3.4 million, which included $2.0 million of goodwill.

On March 31, 2005, the Company exchanged radio station WZFS-FM, Chicago, Illinois for selected assets of radio stations WIND-AM, Chicago, Illinois, KOBT-FM, Houston, Texas and KHCK-AM, Dallas, Texas. The net carrying amount of the assets exchanged approximated $3.9 million. No gain or loss was recognized by the Company as a result of this exchange. The accompanying Consolidated Statement of Operations reflect this transaction as of November 1, 2004, the date the parties entered an LMA pending FCC approval of the exchange.

On June 30, 2005, the Company exchanged radio station KSFB-FM, San Francisco, California for selected assets of radio station KOSL-FM, Sacramento, California. The net carrying amount of the assets exchanged approximated $7.2 million. No gain or loss was recognized by the Company as a result of this exchange. The accompanying Consolidated Statement of Operations reflect this transaction as of November 15, 2004, the date the parties entered an LMA pending FCC approval of the exchange.

On December 15, 2005, the Company purchased Churchstaffing.com, an online job information site, for $3.1 million.

With the exception of the acquisition of KGMZ-FM, Honolulu Hawaii, KGBI-FM, Omaha, Nebraska, KCRO-AM, Omaha, Nebraska, Christianity.com and Churchstaffing.com, which were the acquisitions of businesses, the above radio station acquisitions were acquisitions of assets.

During the year ended December 31, 2004, the Company completed the following transactions:

| **Acquisition Date** | **Station** | **Market Served** | **Acquisition Cost** | | **Format Changed** |
|---|---|---|---|---|---|
| | | | *(Dollars in thousands)* | | |
| May 28, 2004 | KJPN-AM | Honolulu, HI | $ | 500 | Yes |
| June 28, 2004 | WAFS (now WGKA-AM) | Atlanta, GA | | 16,545 | Yes |
| August 13, 2004 | KHUI-FM | Honolulu, HI | | 1,850 | Yes |
| August 13, 2004 | KPOI-FM (now KHNR-FM) | Honolulu, HI | | 1,850 | Yes |
| September 30, 2004 | WQBH-AM (now WDTK-AM) | Detroit, MI | | 4,750 | Yes |
| November 2, 2004 | KIIS-AM | Oxnard-Ventura, CA | | 800 | Yes |
| | | | $ | 26,295 | |

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

| | | Amount | |
|---|---|---|---|
| | | *(Dollars in thousands)* | |
| **Asset** | | | |
| | Property and equipment | $ | 1,865 |
| | Broadcast licenses | | 24,430 |
| | | $ | 26,295 |

On July 30, 2004, the Company acquired the assets of the Internet portal operations of Christianjobs.com for $0.4 million.

On September 29, 2004, the Company entered into an agreement to exchange radio stations WZFS-FM, Chicago, Illinois and KSFB-FM, San Francisco, California for selected assets of radio stations WIND-AM, Chicago, Illinois, KOBT-FM, Houston, Texas, KHCK-AM, Dallas, Texas and KOSL-FM, Sacramento, California. The Company began to operate WIND-AM, Chicago, Illinois, KOBT-FM, Houston, Texas and KHCK-AM, Dallas, Texas effective November 1, 2004 and KOSL-FM, Sacramento, California effective November 15, 2004 under LMAs. Additionally, the Company discontinued operating the stations it divested under an LMA effective November 1, 2004.

**NOTE 3. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consisted of the following:

| | December 31, | |
|---|---|---|
| | 2005 | **2006** |
| | *(Dollars in thousands)* | |
| Land | $ 27,719 | **$ 30,515** |
| Buildings | 17,054 | **24,641** |
| Office furnishings and equipment | 25,303 | **28,110** |
| Antennae, towers and transmitting equipment | 58,716 | **62,360** |
| Studio and production equipment | 26,486 | **27,403** |
| Computer software | 2,734 | **3,212** |
| Record and tape libraries | 194 | **186** |
| Automobiles | 1,006 | **1,087** |
| Leasehold improvements | 11,503 | **12,248** |
| Construction-in-progress | 10,287 | **13,717** |
| | 181,002 | **203,479** |
| Less accumulated depreciation | 64,757 | **74,766** |
| | $ 116,245 | **$ 128,713** |

**NOTE 4. NOTES PAYABLE AND LONG-TERM DEBT**

On June 9, 2006, the Company amended its credit facilities. The primary modifications to the credit agreement included: increasing the loan commitments to $315 million; allowing for the payment of up to $5.0 million per year in dividends and the payment of an additional $30.0 million in dividends during the life of the credit facility; allowing for the repurchase of stock and payment of dividends, in addition to amounts repurchased prior to June 9, 2006, up to $50.0 million when total leverage is greater than 4.00 to 1.00 but less than 5.50 to 1.00 and up to $15 million when total leverage is greater than 5.50 to 1.00; and allowing for the repurchase of stock or the payment of additional dividends with a portion of the proceeds of asset sales.

Long-term debt consisted of the following:

| | December 31, | |
|---|---|---|
| | 2005 | **2006** |
| | *(Dollars in thousands)* | |
| Term loans under credit facility | $ 123,875 | **$ 238,125** |
| Revolving line of credit under credit facility | 6,600 | **19,100** |
| Swingline credit facility | - | **1,241** |
| 9% Senior Subordinated Notes due 2011 (1) | 96,664 | **-** |
| 7¾% Senior Subordinated Notes due 2010 | 100,000 | **100,000** |

| | | |
|---|---|---|
| Fair market value of interest swap of interest rate swap agreement | 215 | **-** |
| Capital leases and other loans | 142 | **2,560** |
| | 327,496 | **361,026** |
| Less current portion | 811 | **2,048** |
| | $ 326,685 | **$ 358,978** |

(1) Includes $2,633 as of December 31, 2005 of fair value adjustments related to terminated interest rate swaps. The principal amount outstanding was $94,031 as of December 31, 2005.

Since the revolving line of credit under the credit facilities and the term loan under the credit facilities carry floating interest rates, the carrying amounts approximate fair market value. The 9% Notes were issued in June 2001 at par. The 7¾% Notes were issued in December 2002 at par. At December 31, 2006, the fair market value of the 7¾% Notes was approximately $101.4 million.

**Revolving Line of Credit with Banks**

HoldCo is the borrower under the Company s credit facilities. On July 7, 2005, the credit facilities were amended to, among other things, add a $150.0 million delayed-draw term loan C facility ( term loan C facility ). The credit facilities, as amended, 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 $150.0 million term loan C facility. As of December 31, 2006, the borrowing capacity and aggregate commitments was $19.1 million under the revolving credit facility, $73.1 million under the term loan B facility and $165.0 million under the term loan C facility. The amount the Company can borrow, however, is subject to certain restrictions as described below. At December 31, 2006, $73.1 million was outstanding under the term loan B facility, $165 million was outstanding under the term loan C facility and $19.1 million was outstanding under the revolving credit facility. The borrowing capacity under the revolving credit facility steps down in three 10% increments commencing June 30, 2007, and matures on March 25, 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 25, 2010, or the date that is six months prior to the maturity of any subordinated indebtedness of Salem or HoldCo. 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 the Company, 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 the Company is required to make these prepayments, the 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 facilitates below $50.0 million.

Amounts outstanding under the credit facilities bear interest at a rate based on, at HoldCo s option, the bank s prime rate or LIBOR, in each case plus a spread. For purposes of determining the interest rate under the 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 December 31, 2006, the blended interest rate on amounts outstanding under the credit facilities was 6.95%. If an event of default occurs, the rate may increase by 2.0%.

The maximum amount that HoldCo may borrow under its credit facilities is limited by a ratio of HoldCo s consolidated existing total adjusted funded debt to pro forma twelve-month cash flow (the Total Leverage Ratio ). HoldCo s credit facilities will allow it to adjust the 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 December 31, 2006. The ratio will decline periodically until December 31, 2007, at which point it will remain at 5.5 to 1 through March 2009. The Total Leverage Ratio under the credit facilities at December 31, 2006, on a pro forma basis, was 5.88 to 1, resulting in a borrowing availability under the term loan C facility and revolving credit facility of approximately $51.9 million.

The credit facilities contain additional restrictive covenants customary for facilities of their size, type and purpose which, with specified exceptions, limits the Company s 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 the Company s business. The credit facilities also require the Company to satisfy specified financial covenants, which covenants require the Company 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 1.5 to 1 through June 29, 2005 increasing in increments to 2.5 to 1 after June 30, 2008), minimum debt service coverage (a static ratio of not less than 1.25 to 1), a maximum consolidated senior leverage ratio (currently 5.00 to 1, which will decline periodically until December 31, 2008, at which point it will remain at 3.5 to 1 through March 2009), and minimum fixed charge coverage (a static ratio of not less than 1.1 to 1). Salem and all of its subsidiaries, except for HoldCo, are guarantors of borrowings under the credit facilities. The credit facilities are secured by liens on all of Salem and its subsidiaries   assets and pledges of all of the capital stock of its subsidiaries.

On October 18, 2006, the Company purchased two interest rate caps for $0.1 million to mitigate exposure to rising interest rates based on LIBOR.  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%.

**Swingline Credit Facility**

On June 1, 2005, the Company entered into an agreement for a swingline credit facility ( Swingline ) with a borrowing capacity of $5.0 million. As collateral for the Swingline, the Company pledged its corporate office building. Amounts outstanding under the Swingline bear interest at a rate based on the bank s prime rate. As of December 31, 2006, $1.2 million was outstanding under the Swingline bearing interest at 8.25%.

**9% Senior Subordinated Notes due 2011**

In June 2001, HoldCo issued $150.0 million principal amount of 9% Notes due 2011. HoldCo used the net proceeds to repay approximately $145.5 million in borrowings under the credit facility. The 9% Notes were redeemable at the option of the Company, in whole or in part, at any time on or after July 1, 2006, at the redemption prices specified in the indenture.

During the quarter ended June 30, 2004, the Company repurchased an aggregate amount of $55.6 million of its 9% Notes through a combination of redemptions and open market repurchases (the Redemption ) pursuant to the terms of the indenture governing the 9% Notes. The Redemption resulted in a loss of approximately $6.6 million. The Company used the proceeds from its follow-on offering of 2.3 million shares of Class A common stock issued in May 2004, to complete the Redemption.

During the year ended December 31, 2005, we repurchased an aggregate amount of $0.3 million of our 9% Notes through open market repurchases. As a result, we reported $24,000 as a loss on early redemption of long-term debt in the Consolidated Statement of Operations.

On July 6, 2006, we, through the borrowings under our term loan C facility, redeemed the remainder of our outstanding 9% Notes. The redemption price, as set for in the notes, of 104.5% of the principal outstanding of $94.0 million, resulted in a pre-tax loss of approximately $3.6 million, including the write-off of unamortized bond issued costs and interest rate swap settlement amounts, which is reported as a loss on early retirement of long-term debt.

**7¾% Senior Subordinated Notes due 2010**

In December 2002, HoldCo issued $100.0 million of the Company s 7¾% Senior Subordinated Notes, the proceeds of which were used to redeem the 9½% Notes on January 22, 2003.

The 7¾% Notes have interest payment dates on June 15 and December 15. Principal is due on the maturity date, December 15, 2010. The 7¾% Notes are redeemable at the option of the Company, in whole or in part, at any time on or after December 15, 2007, at the redemption prices specified in the indenture. The 7¾% Notes are fully and unconditionally guaranteed, jointly and severally, on a senior subordinated basis by the Guarantors (Salem Communications Corporation and all of its subsidiaries (other than HoldCo)). The 7¾% Notes are general unsecured obligations of the Company, subordinated in right of payment to all existing and future senior indebtedness, including the Company s obligations under the Credit Agreement. The indenture limits the incurrence of additional indebtedness by the Company, the payment of dividends, the use of proceeds of certain asset sales, and contains certain other restrictive covenants affecting the Company.

**Other Debt**

The Company has several capital leases related to various data processing equipment. The obligation recorded at December 31, 2005 and 2006 represents the present value of future commitments under the lease agreements.

**Maturities of Long-Term Debt**

Principal repayment requirements under all long-term debt agreements outstanding at December 31, 2006 for each of the next five years and thereafter are as follows:

| | Amount (Dollars in thousands) |
|---|---|
| 2007 | $ 2,048 |
| 2008 | 1,938 |
| 2009 | 21,155 |
| 2010 | 335,885 |
| 2011 | - |
| Thereafter | - |
| | $ 361,026 |

**NOTE 5. INCOME TAXES**

The consolidated provision (benefit) for income taxes from continuing operations for Salem consisted of the following at December 31:

| | 2004 | 2005 | **2006** |
|---|---|---|---|
| | | (Dollars in thousands) | |
| **Current:** | | | |
| Federal | $ | $ 149 | **$ (46)** |
| State | 169 | 251 | **351** |
| | 169 | 400 | **305** |
| **Deferred:** | | | |
| Federal | 5,624 | 7,623 | **9,924** |
| State | (934) | 547 | **938** |
| | 4,690 | 8,170 | **10,862** |
| Provision for income taxes | $ 4,859 | $ 8,570 | **$ 11,167** |

Discontinued operations are reported net of the tax provision (benefit) of ($0.3) million in 2004, ($0.2) million in 2005 and $1.6 million in 2006.

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

| | December 31, | |
|---|---|---|
| | 2005 | **2006** |

| | | |
|---|---|---|
| | *(Dollars in thousands)* | |
| **Deferred tax assets:** | | |
| Financial statement accruals not currently deductible | $ 4,535 | **$ 4,898** |
| Net operating loss, AMT credit and other carryforwards | 34,173 | **35,275** |
| State taxes | 79 | **122** |
| Other | - | **988** |
| Total deferred tax assets | 38,787 | **41,283** |
| Valuation allowance for deferred tax assets | (3,774) | **(4,752)** |
| Net deferred tax assets | $ 35,013 | **$ 36,531** |
| **Deferred tax liabilities:** | | |

| | | |
|---|---|---|
| Excess of net book value of property, plant, equipment and software for financial reporting purposes over tax basis | $ 12,483 | **$ 10,537** |
| Excess of net book value of intangible assets for financial reporting purposes over tax basis | 58,451 | **74,395** |
| Other | 275 | **514** |
| Total deferred tax liabilities | 71,209 | **85,446** |
| Net deferred tax liabilities | $ 36,196 | **$ 48,915** |

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

| | December 31, | |
|---|---|---|
| | 2005 | **2006** |
| | *(Dollars in thousands)* | |
| Deferred income tax asset per balance sheet | $ 4,614 | **$ 5,020** |
| Deferred income tax liability per balance sheet | (40,810) | **(53,935)** |
| | $ (36,196) | **$ (48,915)** |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2005 | **2006** |
| | ***(dollars in thousands)*** | | |
| Statutory federal income tax rate (at 35%) | $ 4,454 | $ 7,563 | **$ 9,700** |
| Effect of state taxes, net of federal | 636 | 518 | **838** |
| Permanent items | (383) | 289 | |