

SALEM COMMUNICATIONS CORP /DE/  
Form 10-Q  
August 09, 2006

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

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**COMMISSION FILE NUMBER 000-26497**

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

**DELAWARE**  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

**77-0121400**  
(I.R.S. EMPLOYER  
IDENTIFICATION NUMBER)

**4880 SANTA ROSA ROAD**  
**CAMARILLO, CALIFORNIA**

**93012**  
(ZIP CODE)

(ADDRESS OF PRINCIPAL EXECUTIVE  
OFFICES)

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

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

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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]

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

Class A  
Common Stock, \$0.01 par value per share

Outstanding at August 1, 2006  
18,793,824 shares

Class B  
Common Stock, \$0.01 par value per share

Outstanding at August 1, 2006  
5,553,696 shares

**SALEM COMMUNICATIONS CORPORATION  
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## **FORWARD LOOKING STATEMENTS**

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

**PART I - FINANCIAL INFORMATION**

**SALEM COMMUNICATIONS CORPORATION**

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





**SALEM COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(IN THOUSANDS, EXCEPT SHARE DATA)**

	December 31, 2005 (Note 1)	June 30, 2006 (Unaudited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,979	\$ 730
Accounts receivable (less allowance for doubtful accounts of \$7,215 in 2005 and \$7,815 in 2006)	30,953	31,125
Other receivables	1,579	895
Prepaid expenses	2,468	2,630
Deferred income taxes	4,614	4,798
Assets of discontinued operations	12,456	10,838
Total current assets	56,049	51,016
Property, plant and equipment, net	116,245	126,018
Broadcast licenses	443,092	475,510
Goodwill	16,803	20,568
Other indefinite-lived intangible assets		2,892
Amortizable intangible assets (net of accumulated amortization of \$7,726 in 2005 and \$9,029 in 2006)	3,244	10,179
Bond issue costs	2,742	2,442
Bank loan fees	3,709	3,474
Fair value of interest rate swap	743	3,744
Other assets	3,303	3,509
Total assets	\$ 645,930	\$ 699,352
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 448	\$ 2,049
Accrued expenses	5,606	5,718
Accrued compensation and related expenses	6,461	6,709
Income taxes payable		157
Accrued interest	5,429	6,019
Deferred revenue	1,903	3,189
Current portion of long-term debt and capital lease obligations	811	94,840
Total current liabilities	20,658	118,681
Long-term debt and capital lease obligations, less current portion	326,685	265,173
Deferred income taxes	40,810	51,440
Deferred revenue	7,304	7,696

Other liabilities	1,355	<b>3,537</b>
Total liabilities	396,812	<b>446,527</b>
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 at December 31, 2005 and 20,412,992 issued and 18,793,824 outstanding at June 30, 2006	204	<b>204</b>
Class B common stock, \$0.01 par value; authorized 20,000,000 shares; issued and outstanding 5,553,696 shares	56	<b>56</b>
Additional paid-in capital	217,036	<b>219,681</b>
Retained earnings	43,043	<b>57,324</b>
Treasury stock	(11,539)	<b>(26,688)</b>
Accumulated other comprehensive income	318	<b>2,248</b>
Total stockholders' equity	249,118	<b>252,825</b>
Total liabilities and stockholders' equity	\$ 645,930	<b>\$ 699,352</b>

See accompanying notes

**SALEM COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)**  
**(UNAUDITED)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	2005	2006	2005	2006
			\$	
Net broadcasting revenue	\$ 50,646	\$ 53,381	97,608	\$ 102,155
Non-broadcast revenue	2,740	4,684	5,168	7,936
Total revenue	53,386	58,065	102,776	110,091
Operating expenses:				
Broadcasting operating expenses, exclusive of depreciation and amortization shown below (including \$282 and \$337 for the quarters ended June 30, 2005 and 2006, respectively, and \$555 and \$614 for the six months ended June 30, 2005 and 2006, respectively, paid to related parties)	30,536	33,498	60,018	65,192
Non-broadcast operating expenses, exclusive of depreciation and amortization shown below	2,494	3,827	4,871	7,259
Corporate expenses, exclusive of depreciation and amortization shown below (including \$95 and \$52 for the quarters ended June 30, 2005 and 2006, respectively, and \$157 and \$150 for the six months ended June 30, 2005 and 2006, respectively, paid to related parties)	4,936	6,256	9,983	12,696
Litigation costs	650		650	
Depreciation and amortization (including \$243 and \$524 for the quarters ended June 30 2005 and	3,355	3,866	6,606	7,161

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2006, respectively, and \$459  
and \$813 for the six months  
ended June 30, 2005 and  
2006, respectively for  
non-broadcast businesses)

(Gain) loss on disposal of  
assets

	55	<b>(15,510)</b>	15	<b>(19,039)</b>
Total operating expenses	42,026	<b>31,937</b>	82,143	<b>73,269</b>
Operating income from continuing operations	11,360	<b>26,128</b>	20,633	<b>36,822</b>
Other income (expense):				
Interest income	22		45	<b>46</b>
Interest expense	(5,593)	<b>(6,779)</b>	(10,705)	<b>(13,367)</b>
Other expense, net	(71)	<b>(174)</b>	(139)	<b>(346)</b>
Income from continuing operations before income taxes	5,718	<b>19,175</b>	9,834	<b>23,155</b>
Provision for income taxes	2,042	<b>7,584</b>	3,579	<b>9,178</b>
Income from continuing operations	3,676	<b>11,591</b>	6,255	<b>13,977</b>
Income (loss) from discontinued operations, net of tax	(123)	<b>(25)</b>	(310)	<b>304</b>
Net income	\$ 3,553	<b>\$ 11,566</b>	5,945	<b>\$ 14,281</b>
Other comprehensive income (loss), net of tax	(1,326)	<b>894</b>	(1,326)	<b>1,930</b>
Comprehensive income	\$ 2,227	<b>\$ 12,460</b>	4,619	<b>16,211</b>
Basic earnings per share from continuing operations	\$ 0.14	<b>\$ 0.48</b>	0.24	<b>\$ 0.57</b>
Income (loss) per share from discontinued operations			(0.01)	<b>0.01</b>
Basic earnings per share	\$ 0.14	<b>\$ 0.48</b>	0.23	<b>\$ 0.58</b>
Diluted earnings per share from continuing operations	\$ 0.14	<b>\$ 0.48</b>	0.24	<b>\$ 0.57</b>
Income (loss) per share from discontinued operations		<b>(0.01)</b>	(0.01)	<b>0.01</b>
Diluted earnings per share	\$ 0.14	<b>\$ 0.47</b>	0.23	<b>\$ 0.58</b>
Basic weighted average shares outstanding	25,887,299	<b>24,347,520</b>	25,925,453	<b>24,516,432</b>
Diluted weighted average shares outstanding	25,939,455	<b>24,356,275</b>	25,981,055	<b>24,525,718</b>

See accompanying notes

**SALEM COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(IN THOUSANDS,)**

**(UNAUDITED)**

	<b>Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
Income from continuing operations	\$ 6,255	\$ 13,977
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Non-cash stock-based compensation		2,620
Tax benefit related to stock options exercised	6	
Depreciation and amortization	6,606	7,161
Amortization of bond issue costs and bank loan fees	716	535
Amortization and accretion of financing items	(433)	(252)
Provision for bad debts	1,413	1,699
Deferred income taxes	3,273	9,160
(Gain) loss on disposal of assets	15	(19,039)
Changes in operating assets and liabilities:		
Accounts receivable	(2,542)	(1,106)
Prepaid expenses and other current assets	1,046	(146)
Accounts payable and accrued expenses	(1,157)	2,565
Deferred revenue	3,888	1,078
Other liabilities	111	(189)
Income taxes payable		157
Net cash provided by continuing operating activities	19,197	18,220
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(7,585)	(11,258)
Deposits on radio station acquisitions	(150)	
Purchases of radio station assets	(40,271)	(19,229)
Purchase of Internet and magazine businesses	(3,407)	(10,509)
Proceeds from sale of property, plant and equipment	62	2,106
Other	639	(206)
	(50,712)	(39,096)

Net cash used in investing activities of continuing operations

### FINANCING ACTIVITIES

Proceeds from issuance of long-term debt and notes payable	30,150	<b>35,000</b>
Repurchase of Class A common stock	(3,784)	<b>(15,149)</b>
Payments of long-term debt and notes payable	(3,400)	<b>(2,002)</b>
Proceeds from exercise of stock options	32	<b>24</b>
Tax benefit related to stock options exercised		<b>1</b>
Payments on capital lease obligations	(13)	<b>(14)</b>
Payments of costs related to bank credit facility and debt financing	24	
Proceeds from interest rate swap termination	3,730	
Net cash provided by financing activities	26,739	<b>17,860</b>

### CASH FLOWS OF DISCONTINUED OPERATIONS

Operating cash flows	(113)	<b>(231)</b>
Investing cash flows	13	<b>(2)</b>
Total cash outflow from discontinued operations	(100)	<b>(233)</b>
Net decrease in cash and cash equivalents	(4,876)	<b>(3,249)</b>
Cash and cash equivalents at beginning of year	10,994	<b>3,979</b>
Cash and cash equivalents at end of period	\$ 6,118	<b>\$ 730</b>
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 10,309	<b>\$ 12,459</b>
Income taxes	\$ 149	<b>\$ 76</b>

See accompanying notes

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

**NOTE 1. BASIS OF PRESENTATION**

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

Information with respect to the three months and six months ended June 30, 2005 and 2006 is unaudited. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the unaudited interim financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended December 31, 2005.

The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP.

**NOTE 2. RECLASSIFICATIONS**

Certain items shown in the 2005 financial statements have been reclassified to conform to the current period 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 3. The accompanying Condensed Consolidated Balance Sheet reflects the net assets of these stations as Assets of discontinued operations as of December 31, 2005. All prior periods have been revised to reflect the operating results and net assets of these stations as discontinued operations. Accordingly, the accompanying Condensed Consolidated Statement of Operations reflects the results of these stations as discontinued operations for the three and six months ended June 30, 2005. The assets of WTSJ-AM and WBOB-AM were sold on February 10, 2006, and the results of operations for 2006 are presented as discontinued operations though the date of the sale. The results of operations of WBTK-AM, WITH-AM, WBGB-FM, WJGR-AM, WZNZ-AM, and WZAZ-AM, are presented as discontinued operations for the three and six months ended June 30, 2006.

**NOTE 3. ACQUISITIONS AND OTHER SIGNIFICANT TRANSACTIONS**

During the six months ended June 30, 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 and WHIM-AM	Orlando, FL	\$	10,000	No
February 3, 2006	WORL-AM	Orlando, FL		3,998	Yes
February 10, 2006	WLQV-AM	Detroit, MI		8,813	No
May 12, 2006	KKFS-FM	Sacramento, CA		21,835	Yes
			\$	44,646	

The purchase price has been allocated to the assets acquired as follows:

Asset	Amount (Dollars in thousands)
Property and equipment	\$ 4,233
Amortizable intangible assets	406
Goodwill	211
Broadcast licenses	39,796
	\$ 44,646

The accompanying Condensed Consolidated Balance Sheet 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 Condensed Consolidated Statement of Operations as of the date of acquisition. The operating results for each of WTLN-AM and WHIM-AM were included in the accompanying Condensed Consolidated Statement of Operations as of 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 Condensed Consolidated Statement of Operations as of 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 selected assets of radio station KNIT-AM, Dallas, Texas, for selected assets of WORL-AM, Orlando, Florida. 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, which was adopted as of January 1, 2006, and resulted in a pre-tax gain on the exchange of \$3.5 million.

On February 10, 2006, the Company exchanged selected assets of radio stations WTSJ-AM, Cincinnati, Ohio, and WBOB-AM, Cincinnati, Ohio and \$6.7 million in cash for selected assets of radio station WLQV-AM, Detroit, Michigan. The accompanying Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2006 reflects WTSJ-AM and WBOB-AM as discontinued operations through the date of the sale. All prior periods, including the three and six months ended June 30, 2005, 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 \$0.4 million, net of taxes.

The Company entered into an agreement on February 10, 2006 to sell radio station WBTK-AM, Richmond, Virginia. The accompanying Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2006 reflects WBTK-AM as a discontinued operation. All prior periods, including the three and six months ended June 30, 2005, have been revised to reflect the operating results of these stations as discontinued operations to conform to the current period presentation. The Company expects this transaction to close in the third quarter of 2006.

On May 12, 2006, the Company exchanged selected assets of 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, which was adopted as of January 1, 2006, and resulted in a gain on the exchange of \$14.6 million. Additionally, the Company sold selected assets of 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 selected assets of WCCD-AM in Cleveland, Ohio, for \$2.1 million resulting in a pre-tax gain of \$1.6 million.

During June 2006, the Company entered into agreements to sell selected assets of WITH-AM, Baltimore, Maryland for \$3.3 million and WBGB-FM, Jacksonville, Florida for \$7.7 million. The Company expects the Baltimore, Maryland transaction to close in the fourth quarter of 2006. The Jacksonville, Florida transaction is expected to close in the second half of 2006, subject to approval of the FCC. The Company has a plan in place to sell selected assets of the other radio stations currently operating in the Jacksonville, Florida market. The

accompanying Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2006, reflects the results of these stations as discontinued operations. All prior periods, including the three and six months ended June 30, 2005, have been revised to reflect the operating results of these stations as discontinued operations 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 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.

On April 28, 2006, the Company acquired the Internet website Townhall.com and its related operations for \$5.0 million, upon which a \$2.6 million dollar 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 has been allocated as follows:

Asset	Amount <i>(Dollars in thousands)</i>
Property and equipment	\$ 391
Amortizable intangible assets	8,073
Goodwill	2,099
Mastheads	2,892
	\$ 13,455

**Other Pending Transactions:**

On April 27, 2006, the Company entered into an agreement to exchange selected assets of radio station KHCM-AM, Honolulu, Hawaii and additional consideration of \$1.0 million for selected assets of radio station KORL-AM, Honolulu, Hawaii. The Company anticipates this transaction will close in the third quarter of 2006.

**NOTE 4. STOCK-BASED COMPENSATION**

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R, Share-Based Payment, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS No. 123R supercedes the Company's previous accounting methodology using the intrinsic value method under Accounting Principles Board ( APB ) No. 25, Accounting for Stock Issued to Employees.

The Company adopted SFAS No. 123R using the modified prospective transition method. Under this transition method, compensation expense recognized during the six months ended June 30, 2006, includes (a) compensation

expense for all share-based awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation expense for all share-based awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. In accordance with the modified prospective transition method, the Company's Condensed Consolidated Financial Statements for prior periods have not been restated to reflect the

impact of SFAS No. 123R. SFAS No. 123R also requires a classification change in the statement of cash flows, whereby the income tax benefits from stock option exercises are reported as a financing cash flow rather than an operating cash flow as previously reported.

On November 10, 2005, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. FAS 123R-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company has elected to adopt the alternative transition method provided in the FASB staff position for calculating the tax effects of share-based compensation according to SFAS No. 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ( APIC Pool ) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC Pool and Condensed Consolidated Statement of Cash Flows of the tax effects of employee and director share-based awards that are outstanding upon adoption of SFAS No. 123R.

### *Stock Options*

The Company has one stock option plan, The Amended and Restated 1999 Stock Incentive Plan (the Plan ), which allows the Company to grant stock options to employees, directors, officers and advisors of the Company. A maximum of 3,100,000 shares are authorized under the Plan. The Company generally awards options for a fixed number of shares at an option price equal to the market price at the date of grant with a four or five year vesting period. Options have a term of five years from the vesting date. As of January 1, 2006, the date the Company adopted SFAS No. 123R, there were 1,924,269 outstanding stock options, of which 1,024,385 were vested. During the six months ended June 30, 2006, the Company granted 344,950 options that vest pro-ratably over the next four years.

A summary of option activity under the Plan as of June 30, 2006, and changes during the period then ended, is presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2006	1,924,269	\$ 23.82		
Granted	344,950	13.67		
Exercised	(2,000)	11.81		\$ 3,460
Forfeited or expired	(87,300)	22.85		
Outstanding at June 30, 2006	2,179,919	\$ 22.27	4.97 years	
Exercisable at June 30, 2006	1,309,667	\$ 25.23	3.42 years	

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model, which is consistent with our valuation techniques previously utilized for options in footnote disclosures required under SFAS No.123, Accounting for Stock-Based Compensation, and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure.

The following table reflects compensation expense recorded during the three and six months ended June 30, 2006 in accordance with SFAS 123R (in thousands):

Stock-Based Compensation Expense	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006
	<i>Dollars in thousands</i>	
Stock-based compensation expense included in corporate expenses in the condensed consolidated statements of operations	\$ 1,123	\$ 2,218
Stock-based compensation expense included in broadcast operating expenses in the condensed consolidated statements of operations	166	373
Stock-based compensation expense included in non-broadcast operating expenses in the condensed consolidated statements of operations	22	29
Total stock-based compensation expense included in the condensed consolidated statements of operations	\$ 1,311	\$ 2,620

In applying the Black-Scholes option-pricing model, the Company uses historical data among other factors to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. The following assumptions were used to estimate the fair value of options granted during the three and six months ended June 30, 2006 using the Black-Scholes option-pricing model:

	Six Months Ended
	June 30, 2006
Expected volatility	49.0%
Expected dividends	0.0%
Expected term (in years)	5 - 8
Risk-free interest rate	5.15%

Prior to January 1, 2006, the Company accounted for stock-based awards under the intrinsic value method, which followed the recognition and measurement principles of APB No. 25 and related interpretations. Under this method, compensation expense was recorded on the date of the grant only if the current market price of the underlying stock exceeded the exercise price. The following table provides the pro forma net income and pro forma earnings per share disclosures for stock-based awards vested during the year as if the fair value method defined in SFAS No. 123, as amended, had been applied:

	Three Months Ended	Six Months Ended
	June 30, 2005	June 30, 2005
Net income, as reported	\$ 3,553	\$ 5,945
Add: Stock-based compensation, as reported		
Deduct: Total stock-based compensation determined under fair value based method for all awards, net of tax	(171)	(1,299)
Pro forma net income	\$ 3,382	\$ 4,646
Earnings per share:		
Basic earnings per share - as reported	\$ 0.14	\$ 0.23
Basic earnings per share - pro forma	\$ 0.13	\$ 0.18
Diluted earnings per share - as reported	\$ 0.14	\$ 0.23
Diluted earnings per share - pro forma	\$ 0.13	\$ 0.18

#### **NOTE 5. OTHER COMPREHENSIVE INCOME**

During the quarter ended June 30, 2006, the Company recorded other comprehensive income of \$0.9 million, net of tax of \$0.6 million, related to the change in fair value of its three cash flow hedges. For the six months ended June 30,



2006, the Company recorded other comprehensive income of \$1.9 million, net of taxes of \$1.3 million, related to the change in fair value of its three cash flow hedges. For the three and six months ended June 30, 2005, the company recorded other comprehensive losses of \$1.3 million, net of tax of \$0.8 million, related to the change in value of its three cash flow hedges.

**NOTE 6. RECENT ACCOUNTING PRONOUNCEMENTS**

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

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109) which is effective for fiscal years beginning after December 15, 2006 with earlier adoption encouraged. This interpretation was issued to clarify the accounting for uncertainty in income

taxes recognized in the financial statements by prescribing 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. This interpretation is effective beginning on January 1, 2007, and is not expected to have a significant impact on the Company's results of operations, cash flows or financial position.

#### NOTE 7. EQUITY TRANSACTIONS

The Company's Board of Directors authorized a \$25.0 million share repurchase program in May 2005. In February 2006, the Board of Directors increased Salem's existing share repurchase program to permit the repurchase of up to an additional \$25.0 million of shares of Salem's Class A common stock.

During the three month period ended June 30, 2006, the Company did not repurchase shares of its Class A common stock. For the six month period ended June 30, 2006, the Company made repurchases of 979,375 shares of its Class A common stock for \$15.1 million. Through June 30, 2006, 1,619,168 shares have been repurchased at an average cost of \$16.48 per share.

During the six month period ended June 30, 2005, Salem made repurchases of 210,319 shares its Class A common stock for approximately \$3.8 million pursuant to a \$25.0 million share repurchase program adopted by Salem's Board of Directors in September 2004.

As discussed in Note 4, the Company adopted SFAS No. 123R as of January 1, 2006. As a result, \$1.3 million and \$2.6 million of stock-based compensation expense has been recorded to additional paid-in capital for the three and six months ended June 30, 2006, respectively.

#### NOTE 8. 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 \$315.0 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, of 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 \$15.0 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	June 30, 2006
	<i>(Dollars in thousands)</i>	
Term loans under credit facility	\$ 123,875	\$ 123,875
Revolving line of credit under credit facility	6,600	39,600
9% Senior Subordinated Notes due 2011 (1)	96,664	96,412
7¾% Senior Subordinated Notes due 2010	100,000	100,000
Fair value of interest swap	215	
Capital leases and other loans	142	126
	327,496	360,013
Less current portion	811	94,840
	\$ 326,685	\$ 265,173

(1) Includes \$2,633 and \$2,381 as of December 31, 2005 and June 30, 2006, respectively, of fair value adjustments related to terminated interest rate swaps. The principal amount outstanding was \$94,031 as of December 31, 2005 and June 30, 2006.

**Maturities of Long-Term Debt**

Principal repayment requirements under all long-term debt agreements outstanding at June 30, 2006 for each of the next five years and thereafter are as follows:

	Amount (Dollars in thousands)
2007	\$ 94,840
2008	775
2009	40,376
2010	221,641
2011	357,632
Fair value of interest rate swap	2,381
	\$ 360,013

As discussed in Note 15, the Company, through borrowings under its term loan C facility, redeemed the remainder of its outstanding 9% senior subordinated notes due July 2011, on July 6, 2006. The redemption price, as set forth in the notes, of 104.5% of the principal outstanding of \$94.0 million, resulted in a loss to be reported in the quarter ended September 30, 2006 of approximately \$3.6 million, which includes the write-off of unamortized bond issue costs and interest rate swap settlement amounts.

**NOTE 9. AMORTIZABLE INTANGIBLE ASSETS**

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

	Cost	As of June 30, 2006		Net
		Accumulated Amortization		
		(Dollars in thousands)		
Customer lists and contracts	\$ 10,404	\$ (5,001)	\$	5,403
Favorable and assigned leases	1,581	(1,102)		479
Domain names	4,487	(994)		3,493
Other amortizable intangible assets	2,736	(1,932)		804
	\$ 19,208	\$ (9,029)	\$	10,179

	Cost	As of December 31, 2005		Net
		Accumulated Amortization		
		(Dollars in thousands)		
Customer lists and contracts	\$ 5,419	\$ (4,062)	\$	1,357

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Favorable and assigned leases	1,581	(1,059)	522
Domain names	1,878	(766)	1,112
Other amortizable intangible assets	2,092	(1,839)	253
	\$ 10,970	\$ (7,726)	\$ 3,244

Based on the amortizable intangible assets as of June 30, 2006, we estimate amortization expense for the next five years to be as follows:

<b>Year Ending December 31,</b>	<b>Amortization Expense</b>	
	<i>(Dollars in thousands)</i>	
2006 (July 1 – December 31)	\$	1,518
2007		2,530
2008		2,044
2009		807
2010		352
Thereafter		2,928
Total	\$	10,179

#### **NOTE 10. BASIC AND DILUTED EARNINGS PER SHARE**

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

Options to purchase 1,756,494 and 2,179,919 shares of Class A common stock were outstanding at June 30, 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. Those options are excluded due to their antidilutive effect.

#### **NOTE 11. 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 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, the Company had an interest rate swap agreement with a notional principal amount of \$66.0 million. This agreement related to its \$94.4 million 9% Notes. This agreement was

scheduled to expire in 2011 when the 9% Notes were scheduled 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 being amortized as a reduction of interest expense over the remaining life of the 9% Notes. Interest expense for the three and six months ended June 30, 2006 was reduced by \$0.2 and \$0.3 million, respectively, related to the amortization of the buyout premium received. Because this fair value hedge was effective (that is, the change in the fair value of the hedge instrument was designed to be equal to the change in the fair value of the item being hedged), there was no income statement effect relative to the change in the fair value of the swap agreement.

Interest expense for the three months ended March 31, 2005, was reduced by \$0.3 million as a result of the difference between the 9.0% fixed interest rate on the 9% hedged debt and the floating interest rate under the swap agreement, which was 5.88% from January 1, 2005 through February 18, 2005.

On April 8, 2005, the Company entered into a forward-looking interest rate swap arrangement for the notional principal amount of \$30.0 million whereby it will pay a fixed interest rate of 4.99% as compared to LIBOR on a future bank credit facility borrowing. As of June 30, 2006, the Company recorded an asset for the fair value of the interest swap of approximately \$0.9 million. This amount, net of income tax benefits of approximately \$0.3 million, is reflected in other comprehensive income, as the Company designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap is July 1, 2006 and the expiration date is July 1, 2012.

On April 26, 2005, the Company entered into a second forward-looking interest rate swap arrangement for the notional principal amount of \$30.0 million whereby it will pay a fixed interest rate of 4.70% as compared to LIBOR on a future bank credit facility borrowing. As of June 30, 2006, the Company recorded an asset for the fair value of the interest swap of approximately \$1.3 million. This amount, net of income taxes of approximately \$0.5 million, is reflected in other comprehensive income, as the Company designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap is July 1, 2006 and the expiration date is July 1, 2012.

On May 5, 2005, the Company entered into a third forward-looking interest rate swap arrangement for the notional principal amount of \$30.0 million whereby it will pay a fixed interest rate of 4.53% as compared to LIBOR on a future bank credit facility borrowing. As of June 30, 2006, the Company recorded an asset for the fair value of the interest swap of approximately \$1.6 million. This amount, net of income taxes of approximately \$0.6 million, is reflected in other comprehensive income, as we designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap is July 1, 2006 and the expiration date is July 1, 2012.

#### **NOTE 12. COMMITMENTS AND CONTINGENCIES**

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

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 us, our directors, certain of our 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 provides for a full settlement of these claims in exchange for payment of \$1.85 million to be paid by the company and its insurance carrier. The settlement is subject to certain conditions set forth in the stipulation. 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.

#### **NOTE 13. SEGMENT DATA**



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

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

**NOTE 13. SEGMENT DATA (CONTINUED)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	2005	2006	2005	2006
	<i>(Dollars in thousands)</i>			
Net revenue				
Radio broadcasting	\$ 50,646	\$ <b>53,381</b>	\$ 97,608	\$ <b>102,155</b>
Non-broadcast	2,740	<b>4,684</b>	5,168	<b>7,936</b>
Consolidated net revenue	\$ 53,386	\$ <b>58,065</b>	\$ 102,776	\$ <b>110,091</b>
Operating expenses before litigation costs, depreciation, amortization and loss on disposal of assets				
Radio broadcasting	\$ 30,536	\$ <b>33,498</b>	\$ 60,018	\$ <b>65,192</b>
Non-broadcast	2,494	<b>3,827</b>	4,871	<b>7,259</b>
Corporate	4,936	<b>6,256</b>	9,983	<b>12,696</b>
Consolidated operating expenses before litigation costs, depreciation, amortization and (gain) loss on disposal of assets	\$ 37,966	\$ <b>43,581</b>	\$ 74,872	\$ <b>85,147</b>
Operating income from continuing operations before litigation costs, depreciation, amortization and (gain) loss on disposal of assets				
Radio broadcasting	\$ 20,110	\$ <b>19,883</b>	\$ 37,590	\$ <b>36,963</b>
Non-broadcast	246	<b>857</b>	297	<b>677</b>
Corporate	(4,936)	<b>(6,256)</b>	(9,983)	<b>(12,696)</b>
Consolidated operating income from continuing operations before litigation costs, depreciation, amortization and (gain) loss on disposal of assets	\$ 15,420	\$ <b>14,484</b>	\$ 27,904	\$ <b>24,944</b>
Depreciation				
Radio broadcasting	\$ 2,641	\$ <b>2,728</b>	\$ 5,242	\$ <b>5,154</b>
Non-broadcast	116	<b>123</b>	195	<b>194</b>
Corporate	225	<b>262</b>	431	<b>510</b>
Consolidated depreciation expense	\$ 2,982	\$ <b>3,113</b>	\$ 5,868	\$ <b>5,858</b>
Amortization				
Radio broadcasting	\$ 243	\$ <b>348</b>	\$ 467	\$ <b>675</b>
Non-broadcast	127	<b>401</b>	264	<b>619</b>

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	3	4	7	9
Corporate				
Consolidated amortization expense	\$ 373	\$ <b>753</b>	\$ 738	\$ <b>1,303</b>
Operating income from continuing operations before litigation costs and loss on disposal of assets				
Radio broadcasting	\$ 17,226	\$ <b>16,807</b>	\$ 31,881	\$ <b>31,134</b>
Non-broadcast	3	<b>333</b>	(162)	<b>(136)</b>
Corporate	(5,164)	<b>(6,522)</b>	(10,421)	<b>(13,215)</b>
Consolidated operating income from continuing operations before litigation costs and (gain) loss on disposal of assets	\$ 12,065	\$ <b>10,618</b>	\$ 21,298	\$ <b>17,783</b>

**NOTE 13. SEGMENT DATA (CONTINUED)**

	December 31, 2005	June 30, 2006
	<i>(Dollars in thousands)</i>	
Total property, plant and equipment, net		
Radio broadcasting	\$ 112,763	\$ <b>115,276</b>
Non-broadcast	311	<b>3,248</b>
Corporate	3,171	<b>7,494</b>
Consolidated property, plant and equipment, net	\$ 116,245	\$ <b>126,018</b>
Goodwill		
Radio Broadcasting	\$ 4,703	\$ <b>5,015</b>
Non-broadcast	12,100	<b>15,553</b>
Corporate		
Consolidated Goodwill	\$ 16,803	\$ <b>20,568</b>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
	<i>(Dollars in thousands)</i>			
Operating income before litigation costs, depreciation, amortization, and loss on disposal of assets	\$ 15,420	\$ <b>14,484</b>	\$ 27,904	\$ <b>24,944</b>
Depreciation expense	(2,982)	<b>(3,113)</b>	(5,868)	<b>(5,858)</b>
Amortization expense	(373)	<b>(753)</b>	(738)	<b>(1,303)</b>
Litigation costs	(650)		(650)	
Interest income	22		45	<b>46</b>
Loss on disposal of assets	(55)	<b>15,510</b>	(15)	<b>19,039</b>
Interest expense	(5,593)	<b>(6,779)</b>	(10,705)	<b>(13,367)</b>
Other income (expense), net	(71)	<b>(174)</b>	(139)	<b>(346)</b>
Income from continuing operations before income	\$ 5,718	\$ <b>19,175</b>	\$ 9,834	\$ <b>23,155</b>

taxes

**NOTE 14. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS**

The following is the consolidating information of Salem Communications Corporation for purposes of presenting the financial position and operating results of Salem Communications Holding Corporation ( HoldCo ) as the issuer of the 9% Notes and the 7¾% Notes and its guarantor subsidiaries on a consolidated basis and the financial position and operating results of the other guarantors, which are consolidated within the Company. Separate financial information of HoldCo on an unconsolidated basis is not presented because HoldCo has substantially no assets, operations or cash other than its investments in subsidiaries. Each guarantor has given its full and unconditional guarantee, on a joint and several basis, of indebtedness under the 9% Notes and the 7¾% Notes. HoldCo and Salem Communications Acquisition Corporation ( AcquisitionCo ) are 100% owned by Salem and HoldCo owns 100% of all of its subsidiaries. All subsidiaries of HoldCo are guarantors. OnePlace, LLC and CCM Communications, Inc., are aggregated and collectively referred to as Non-broadcast. The net assets of HoldCo are subject to certain restrictions which, among other things, require HoldCo to maintain certain financial covenant ratios, and restrict HoldCo and its subsidiaries from transferring funds in the form of dividends, loans or advances without the consent of the holders of the 9% Notes and the 7¾% Notes. The restricted net assets of HoldCo as of June 30, 2006, amounted to \$177.5 million. Included in intercompany receivables of HoldCo presented in the consolidating balance sheet below is \$41.9 million of amounts due from Salem and AcquisitionCo as of June 30, 2006.

**NOTE 14. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (CONTINUED)**

**SALEM COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**(IN THOUSANDS)**  
**(UNAUDITED)**

	As of June 30, 2006					
	Guarantors		Other		Issuer and	
	Parent	AcquisitionCo	Media	HoldCo	Adjustments	Salem Consolidated
Current assets:						
Cash and cash equivalents	\$	\$ 18	\$ 335	\$ 377	\$	\$ 730
Accounts receivable, net		1,764	1,785	27,672	(96)	31,125
Other receivables		13	17	865		895
Prepaid expenses		25	111	2,494		2,630
Discontinued Operations		10,080		758		10,838
Deferred income taxes		807	828	4,614	(1,451)	4,798
Total current assets		12,707	3,076	36,780	(1,547)	51,016
Investment in subsidiaries	204,411				(204,411)	
Property, plant and equipment, net		3,383	2,042	120,593		126,018
Broadcast licenses		86,229		389,281		475,510
Goodwill		8	12,776	7,784		20,568
Other indefinite-lived intangible assets			2,892			2,892
Amortizable intangible assets, net			7,497	2,682		10,179
Bond issue costs				2,442		2,442
Bank loan fees				3,474		3,474
FV of interest rate swap				3,744		3,744
Intercompany receivables	98,756	6,323		56,314	(161,393)	

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Other assets			71	3,438		3,509
Total assets	\$303,167	\$ 108,650	\$ 28,354	\$ 626,532	\$(367,351)	\$ 699,352

**NOTE 14. CONSOLIDATING FINANCIAL STATEMENTS (CONTINUED)**

**SALEM COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**(IN THOUSANDS)**  
**(UNAUDITED)**

	As of June 30, 2006						
	Guarantors					Issuer and Guarantor Subsidiaries	
	Parent	AcquisitionCo	Other Media	HoldCo	Adjustments	Salem Consolidated	
Current liabilities:							
Accounts payable	\$ 577	\$ (15)	\$ 135	\$ 1,352	\$	\$ 2,049	
Accrued expenses		242	484	5,032	(40)	5,718	
Accrued compensation and related expenses	1	168	423	6,117		6,709	
Accrued interest				6,019		6,019	
Income taxes payable		1	1	155		157	
Deferred revenue			2,811	378		3,189	
Current portion of long-term debt and capital lease obligations				94,840		94,840	
Total current liabilities	578	396	3,854	113,893	(40)	118,681	
Intercompany payables	48,175	69,859	33,499	9,916	(161,449)		
Long-term debt and capital lease obligations, less current portion		54		265,119		265,173	
Deferred income taxes	1,589			51,302	(1,451)	51,440	



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Deferred revenue			64	7,632		7,696
Other liabilities			2,371	1,166		3,537
Stockholders equity	252,825	38,341	(11,434)	177,504	(204,411)	252,825
Total liabilities and stockholders equity	\$ 303,167	\$ 108,650	\$ 28,354	\$ 626,532	\$ (367,351)	\$ 699,352

**NOTE 14. CONSOLIDATING FINANCIAL STATEMENTS (CONTINUED)**

**SALEM COMMUNICATIONS CORPORATION**  
**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**  
**(IN THOUSANDS)**  
**(UNAUDITED)**

Six Months Ended June 30, 2006

	Guarantors			Other Media	HoldCo	Issuer and Guarantor Subsidiaries	Salem Consolidated
	Parent	AcquisitionCo	Adjustments				
Net broadcasting revenue	\$	\$ 5,989	\$	\$ 97,421	\$ (1,255)	\$	102,155
Non-broadcast revenue			8,049	409	(522)		7,936
Total revenue		5,989	8,049	97,830	(1777)		110,091
Operating expenses:							
Broadcasting operating expenses		4,596		61,208	(612)		65,192
Non-broadcast operating expenses			8,374	50	(1,165)		7,259
Corporate expenses				12,696			12,696
Depreciation and amortization		293	813	6,055			7,161
Gain on disposal of assets		1		(19,040)			(19,039)
Total operating expenses		4,890	9,187	60,969	(1,777)		73,269
Operating income (loss)		1,099	(1,138)	36,861	(25)		36,822
Other income (expense):							
Equity in earnings of consolidated subsidiaries, net	14,075				(14,075)		
Interest income	3,005			3,852	(6,811)		46
Interest expense	(2,677)	(2,838)	(1,142)	(13,521)	6,811		(13,367)

Other expense, net				(346)			(346)
Income (loss) before income taxes	14,403	(1,739)	(2,280)	26,846	(14,075)		23,155
Provision (benefit) for income taxes	122	(805)	(827)	10,688			9,178
Net income (loss) before discontinued operations	14,281	(934)	(1,453)	16,158	(14,075)		13,977
Discontinued operations		(2)		306			304
Net income (loss)	\$ 14,281	\$ (936)	\$ (1,453)	\$ 16,464	\$ (14,075)	\$	14,281
Other comprehensive income				1,930			1,930
Comprehensive income (loss)	\$ 14,281	\$ (936)	\$ (1,453)	\$ 18,394	\$ (14,075)	\$	16,211

**NOTE 15. SUBSEQUENT EVENTS**

On July 6, 2006, the Company redeemed the remainder of its outstanding 9% senior subordinated notes due July 2011 through a borrowing under our term loan C facility. The redemption price, as set forth in the notes, of 104.5% of the principal outstanding of \$94.0 million, resulted in a loss to be reported in the quarter ended September 30, 2006, of approximately \$3.6 million, which includes the write-off of unamortized bond issue costs and interest rate swap settlement amounts.

On July 12, 2006, the Company announced that its Board of Directors declared a special cash dividend of \$0.60 per share on its Class A and Class B common stock was paid on July 28, 2006 to shareholders of record at the close of business on July 17, 2006. The dividend payment was approximately \$14.6 million.

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

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

We believe that we are the largest commercial U.S. radio broadcasting company, measured by number of stations and audience coverage, providing programming targeted at audiences interested in Christian and family-themed radio programming. Our core business is the ownership and operation of radio stations in large metropolitan markets. Upon completion of all announced transactions, we will own a national portfolio of 102 radio stations in 39 markets, including 65 stations in 23 of the top 25 markets, which consist of 31 FM stations and 71 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® is a national radio advertising sales firm with offices in 13 U.S. cities. Additionally, Salem Web Network™ (“SWN”), a provider of online Christian content and streaming, and Salem Publishing™, a leading publisher of Christian magazines and books, are owned and operated by Salem.

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 and conservative values programming. Our national presence gives advertisers a station platform that is a unique and powerful way to reach a Christian audience. We program 44 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 33 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.

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

### OVERVIEW

As a radio broadcasting company with a national radio network, we derive our 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 applicable market,
- 
- the general economic conditions in the applicable market, and
- 
- supply and demand on both a local and national level.

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

Our broadcasting revenue is affected primarily by the program rates our radio stations charge 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. Historically we have not subscribed to traditional audience measuring services. 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 general 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 generally 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 on a per program aired 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 customer and listener 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 2005, 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 promotion 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™, our Internet business, earns its revenue from sales of streaming services, sales of banner advertising and sponsorships on the Internet, 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 printing books. The revenue and related operating expenses of these businesses are reported as Non-broadcast in our Condensed Consolidated Statements 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**

	Three Months Ended			Six Months Ended		
	June 30,			June 30,		
	2005	2006	% Change	2005	2006	% Change
Net broadcasting revenue	\$ 50,646	\$ 53,381	5.4%	\$ 97,608	\$ 102,155	4.7%
Non-broadcast revenue	2,740	4,684	70.9%	5,168	7,936	53.6%
Total revenue	53,386	58,065	8.8%	102,776	110,091	7.1%
Operating expenses:						
Broadcasting operating expenses	30,536	33,498	9.7%	60,018	65,192	8.6%
Non-broadcast operating expenses	2,494	3,827	53.4%	4,871	7,259	49.0%
Corporate expenses	4,936	6,256	26.7%	9,983	12,696	27.2%
Litigation costs	650		(100.0%)	650		(100.0%)
Depreciation and amortization	3,355	3,866	0.2%	6,606	7,161	8.4%
(Gain) loss on disposal of assets	55	(15,510)	(28300.0%)	15	(19,039)	(127026.7%)
Total operating expenses	42,026	31,937	(24.0%)	82,143	73,269	(10.8%)
Operating income from continuing operations	11,360	26,128	130.0%	20,633	36,822	78.5%
Other income (expense):						
Interest income	22		100.0%	45	46	2.2%
Interest expense	(5,593)	(6,779)	21.2%	(10,705)	(13,367)	24.9%
Other income (expense), net	(71)	(174)	145.1%	(139)	(346)	148.9%
Income from continuing operations before income taxes	5,718	19,175	235.3%	9,834	23,155	135.5%
Provision for income taxes	2,042	7,584	271.4	3,579	9,178	156.4
Income from continuing operations	3,676	11,591	215.3%	6,255	13,977	123.5
Income (loss) from discontinued operations, net of tax	(123)	(25)	(79.7%)	(310)	304	(198.1%)
Net income			225.5%	\$ 5,945	\$ 14,281	140.2%



\$	\$
3,553	<b>11,566</b>

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>
Net broadcasting revenue	95 %	<b>92 %</b>	95 %	<b>93 %</b>
Non-broadcast revenue	5 %	<b>8 %</b>	5 %	<b>7 %</b>
Total revenue	100 %	<b>100 %</b>	100 %	<b>100 %</b>
Operating expenses:				
Broadcasting operating expenses	59 %	<b>58 %</b>	58 %	<b>59 %</b>
Non-broadcast operating expenses	5 %	<b>7 %</b>	5 %	<b>7 %</b>
Corporate expenses	10 %	<b>11 %</b>	10 %	<b>12 %</b>
Litigation costs	1 %	<b>%</b>	1 %	<b>%</b>
Depreciation and amortization	6 %	<b>6 %</b>	6 %	<b>6 %</b>
(Gain) loss on disposal of assets	%	<b>(17) %</b>	%	<b>(17) %</b>
Total operating expenses	81 %	<b>65 %</b>	80 %	<b>67 %</b>
Operating income from continuing operations	19 %	<b>35 %</b>	20 %	<b>33 %</b>
Other income (expense):				
Interest income	%	<b>%</b>	%	<b>%</b>
Interest expense	(11) %	<b>(13) %</b>	(10) %	<b>(12) %</b>
Other expense, net	%	<b>%</b>	%	<b>%</b>
Income from continuing operations before income taxes	8 %	<b>22 %</b>	10 %	<b>21 %</b>
Provision for income taxes	3 %	<b>3 %</b>	4 %	<b>8 %</b>
Income from continuing operations	5 %	<b>19 %</b>	6 %	<b>13 %</b>
Discontinued operations, net of tax	%	<b>1 %</b>	%	<b>%</b>
Net income	5 %	<b>20 %</b>	6 %	<b>13 %</b>

***Three months ended June 30, 2006 compared to three months ended June 30, 2005***

**NET BROADCASTING REVENUE.** Net broadcasting revenue increased \$2.8 million or 5.4% to \$53.4 million for the quarter ended June 30, 2006 from \$50.6 million for the same quarter of the prior year. On a same station basis, net broadcasting revenue improved \$1.4 million or 2.9% to \$51.4 million for the quarter ended June 30, 2006 from \$50.0 million for the same quarter of the prior year. The growth is primarily attributable to an increase of \$1.2 million in national program revenue on our Christian Teaching and Talk stations and increases on our News Talk stations in local spot revenue of \$0.7 million and in local program revenue of \$0.6 million. Revenue from advertising as a percentage of our gross broadcasting revenue decreased to 52.5% for the quarter ended June 30, 2006 from 54.0% for the same quarter of the prior year. Revenue from block program time as a percentage of our gross broadcasting revenue increased to 34.6% for the quarter ended June 30, 2006 from 32.3% for the same quarter of the prior year. This change in our revenue mix was primarily due to additional program revenue on our News Talk stations and continued program revenue growth on our Christian Teaching and Talk radio stations, compounded by an overall

trend in the radio broadcasting industry of negative growth of advertising revenue. We anticipate that this trend in the radio broadcasting industry may continue, however we cannot quantify the financial impact on our future operating results.

*NON-BROADCAST REVENUE.* Non-broadcast revenue increased \$2.0 million or 70.9% to \$4.7 million for the quarter ended June 30, 2006 from \$2.7 million for the same quarter of the prior year. This increase was due primarily to our acquisitions of The Singing News, CrossDaily.com, Townhall.com, Preaching Magazine and Xulon Press during 2006.

*BROADCASTING OPERATING EXPENSES.* Broadcasting operating expenses increased \$3.0 million or 9.7% to \$33.5 million for the quarter ended June 30, 2006 from \$30.5 million for the same quarter of the prior year.

On a same station basis, broadcasting operating expenses increased \$1.5 million or 4.8% to \$31.3 million for the quarter ended June 30, 2006 from \$29.8 million for the same quarter of the prior year. The increase is primarily due to higher payroll and related overhead costs of \$1.0 million, increased professional services and production costs of \$0.7 million and higher facility costs of \$0.3 million, due to station acquisitions and growth of our Christian Teaching and Talk and News Talk platforms. Additionally, \$0.2 million of non-cash stock-based compensation expense associated with the implementation of Statement of Financial Accounting Standards ( SFAS ) No. 123R, Share-Based Payment on January 1, 2006, was recognized for the quarter ended June 30, 2006.

*NON-BROADCAST OPERATING EXPENSES.* Non-broadcast operating expenses increased \$1.3 million or 53.4% to \$3.8 million for the quarter ended June 30, 2006 from \$2.5 million for the same quarter of the prior year. The increase is attributable primarily to costs associated with our acquisitions of The Singing News, CrossDaily.com, Townhall.com, Preaching Magazine and Xulon Press during 2006.

*CORPORATE EXPENSES.* Corporate expenses increased \$1.4 million or 26.7% to \$6.3 million for the quarter ended June 30, 2006 from \$4.9 million for the same quarter of the prior year. The increase is primarily due to \$1.1 million of non-cash stock-based compensation expense associated with the implementation of SFAS No. 123R, Share-Based Payment on January 1, 2006, that was recognized for the quarter ended June 30, 2006, a \$0.1 million increase in research and development costs, and a \$0.1 million increase in travel costs.

*LITIGATION COSTS.* During the quarter ended June 30, 2005, the Company recorded a \$0.7 million accrual for potential litigation costs.

*DEPRECIATION AND AMORTIZATION.* Depreciation and amortization expense increased \$0.5 million or 15.2% to \$3.9 million for the quarter ended June 30, 2006 from \$3.4 million for the same quarter of the prior year. The increase is due primarily to depreciation associated with the acquisition of radio station and non-broadcast assets during 2006.

*(GAIN) LOSS ON DISPOSAL OF ASSETS.* The gain on disposal of assets of \$15.5 million for the quarter ended June 30, 2006 was primarily due to gains recognized on various exchange transactions accounted for under SFAS No. 153, which was adopted on January 1, 2006. Selected assets of KLMG-FM, Sacramento, California, were exchanged for selected assets of radio station KKFS-FM, Sacramento, California, which resulted in a pre-tax gain of \$14.6 million. Additionally, we sold selected assets of WCCD-AM in Cleveland, Ohio, for \$2.1 million resulting in a pre-tax gain of \$1.6 million, which was partially offset by a sale of selected assets of KBAA-FM, Sacramento, California, for \$0.5 million, resulting in a pre-tax loss of \$0.6 million. The loss on disposal of assets of approximately \$55,000 for the quarter ended June 30, 2005 was primarily due to the write-off of certain assets that were damaged in various storms.

*OTHER INCOME (EXPENSE).* Interest income of approximately \$22,000 for the quarter ended June 30, 2005 was primarily from interest earned on excess cash. Interest expense increased \$1.2 million or 21.2% to \$6.8 million for the quarter ended June 30, 2006 from \$5.6 million for the same quarter of the prior year. The increase is primarily due to increased borrowings and higher interest rates under our credit facilities. Other expense, net, of \$0.2 million and \$0.1 million for the quarters ended June 30, 2006 and June 30, 2005, respectively, was primarily related to bank commitment fees associated with our credit facilities.

*PROVISION FOR INCOME TAXES.* Provision for income taxes was \$7.6 million for the quarter ended June 30, 2006 as compared to \$2.0 million for the same quarter of the prior year. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 39.6% for the quarter ended June 30, 2006 and 35.7% for the same quarter of the prior year. For the quarters ended June 30, 2006 and 2005, the effective tax rate differs from the federal statutory income rate of 35.0% primarily 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 use of certain state net operating loss carryforwards.

*INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX.* Loss from discontinued operations was approximately \$25,000 net of income taxes for the quarter ended June 30, 2006 and includes the operating results of WBTK-AM, WITH-AM, WBGB-FM, WJGR-AM, WZNZ-AM and WZAZ-AM, which are presented as discontinued operations for the quarter ended June 30, 2006 as discussed in Note 3. The \$0.1 million loss recognized for the same quarter of last year represents the operating results 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 presentation.

*NET INCOME.* We recognized net income of \$11.6 million for the quarter ended June 30, 2006 as compared to \$3.6 million for the same quarter of the prior year. The change is primarily due to a gain on the disposal of assets of \$15.5 million recognized during the quarter ended June 30, 2006 offset by an increase of \$3.0 million in broadcast operating expenses and an increase of \$1.4 million in corporate operating expenses.

***Six months ended June 30, 2006 compared to six months ended June 30, 2005***

*NET BROADCASTING REVENUE.* Net broadcasting revenue increased \$4.6 million or 4.7% to \$102.2 million for the six months ended June 30, 2006 from \$97.6 million for the same period of the prior year. On a same station basis, net broadcasting revenue improved \$1.7 million or 1.8% to \$97.7 million for the six months ended June 30, 2006 from \$96.0 million for the same period of the prior year. The growth is primarily attributable to increases in net broadcasting revenue from our News Talk platform of approximately \$2.3 million and our Christian Teaching and Talk stations of \$1.8 million. Revenue from advertising as a percentage of our gross broadcasting revenue decreased to 51.6% for the six months ended June 30, 2006 from 53.4% for the same period of the prior year. Revenue from block program time as a percentage of our gross broadcasting revenue increased to 35.3% for the six months ended June 30, 2006 from 32.8% for the same period of the prior year. This change in our revenue mix was primarily due to additional program revenue on our News Talk stations and continued program revenue growth on our Christian Teaching and Talk radio stations, compounded by an overall trend in the radio broadcasting industry of negative growth of advertising revenue. We anticipate that this trend in the radio broadcasting industry may continue, however we cannot quantify the financial impact on our future operating results.

*NON-BROADCAST REVENUE.* Non-broadcast revenue increased \$2.7 million or 53.6% to \$7.9 million for the six months ended June 30, 2006 from \$5.2 million for the same period of the prior year. This increase was due primarily to growth associated with our acquisitions of The Singing News, CrossDaily.com, Townhall.com, Preaching Magazine, and Xulon Press during 2006.

*BROADCASTING OPERATING EXPENSES.* Broadcasting operating expenses increased \$5.2 million or 8.6% to \$65.2 million for the six months ended June 30, 2006 from \$60.0 million for the same period of the prior year. On a same station basis, broadcasting operating expenses increased \$1.7 million or 3.0% to \$60.1 million for the six months ended June 30, 2006 from \$58.4 million for the same period of the prior year. The increase is primarily due to higher payroll and related overhead costs of \$2.0 million, increased professional services and production costs of \$1.0 million, higher facility costs of \$0.6 million, an increase in bad debt expense of \$0.4 million, and increased legal fees \$0.2 million. Additionally, \$0.4 million of non-cash stock-based compensation expense associated with the implementation of SFAS No. 123R, Share-Based Payment on January 1, 2006, was recognized during the six months ended June 30, 2006.

*NON-BROADCAST OPERATING EXPENSES.* Non-broadcast operating expenses increased \$2.4 million or 49.0% to \$7.3 million for the six months ended June 30, 2006 from \$4.9 million for the same period of the prior year. The increase is attributable primarily to costs associated with our acquisitions of The Singing News, CrossDaily.com, Townhall.com, Preaching Magazine, and Xulon Press during 2006.

*CORPORATE EXPENSES.* Corporate expenses increased \$2.7 million or 27.2% to \$12.7 million for the six months ended June 30, 2006 from \$10.0 million for the same period of the prior year. The increase is primarily due to \$2.2 million of non-cash stock-based compensation expense associated with the implementation of SFAS No. 123R, Share-Based Payment on January 1, 2006, higher travel costs of \$0.2 million and higher research and development costs of \$0.2 million.

*LITIGATION COSTS.* During the six months ended June 30, 2005, the Company recorded a \$0.7 million accrual for litigation costs.

*DEPRECIATION AND AMORTIZATION.* Depreciation and amortization expense increased \$0.6 million or 8.4% to \$7.2 million for the six months ended June 30, 2006 from \$6.6 million for the same period of the prior year. The increase is due primarily to depreciation associated with the acquisition of radio station and non-broadcast assets during 2005 and 2006.

*(GAIN) LOSS ON DISPOSAL OF ASSETS.* The gain on disposal of assets of \$19.0 million for the six months ended June 30 2006 was primarily due to gains recognized on various exchange transactions accounted for under SFAS No. 153, which was adopted on January 1, 2006. Selected assets of KLMG-FM, Sacramento, California, were exchanged for selected assets of radio station KKFS-FM, Sacramento, California, which resulted in a pre-tax gain of \$14.6 million. Additionally, we sold selected assets of WCCD-AM in Cleveland, Ohio, for \$2.1 million resulting in a pre-tax gain of \$1.6 million, which was partially offset by a sale of selected assets of KBAA-FM, Sacramento, California, for \$0.5 million, resulting in a pre-tax loss of \$0.6 million. We also exchanged selected assets of KNIT-AM, Dallas, Texas for selected assets of WORL-AM, Orlando, Florida, resulting in a pre-tax gain on the exchange of \$3.5 million. The net loss on disposal of assets of approximately \$15,000 for the six months ended June 30, 2005 was primarily due to the write-off of certain assets that were damaged in various storms, partially offset by insurance proceeds received from three separate claims

*OTHER INCOME (EXPENSE).* Interest income of approximately \$46,000 and \$45,000 for the six months ended June 30, 2006 and 2005, respectively, was primarily from interest earned on excess cash. Interest expense increased \$2.7 million or 24.9% to \$13.4 million for the six months ended June 30, 2006 from \$10.7 million for the same period of the prior year. The increase is primarily the result of increased borrowings and higher interest rates under our credit facilities. Other expense, net, of \$0.3 million and \$0.1 million for the six months ended June 30, 2006 and 2005, respectively was related to bank commitment fees associated with our credit facilities.

*PROVISION FOR INCOME TAXES.* Provision for income taxes was \$9.2 million for the six months ended June 30, 2006 as compared to \$3.6 million for the same period of the prior year. Provision for income taxes as a percentage of income before income taxes (that is, the effective tax rate) was 39.6% for the six months ended June 30, 2006 and 36.4% for the same period of the prior year. For the six months ended June 30, 2006 and 2005, the effective tax rate differs from the federal statutory income rate of 35.0% primarily due to the effect of state income taxes, and certain expenses that are not deductible for tax purposes and changes in the valuation allowance from the use of certain state net operating loss carryforwards.

*INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX.* The gain from discontinued operations of \$0.3 million, net of taxes, for the six months ended June 30, 2006 includes a pre-tax gain of \$0.7 million from the sale of WTSJ-AM, Cincinnati, Ohio and WBOB-AM, Cincinnati, Ohio, offset with the operating losses of these stations through the date of the sale, along with the operating results of WBTK-AM, WITH-AM, WBGB-FM, WJGR-AM, WZNZ-AM, and WZAZ-AM, which are presented as discontinued operations for the quarter ended June 30, 2006 as discussed in Note 3. The \$0.3 million loss recognized for the same period of last year represents the operating results 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 presentation.

*NET INCOME.* We recognized net income of \$14.3 million for the six months ended June 30, 2006 as compared to net income of \$5.9 million for the same period of the prior year. The change is due to an increase in operating income of \$16.1 million the six months ended June 30, 2006 as compared to the six months ended June 30, 2006, primarily resulting from gains on asset disposals of \$19.0 million offset by increased broadcast operating expenses of \$5.2 million, increased corporate operating expenses of \$2.7 million and increased non-broadcast operating expenses of \$2.4 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.

SOI is not a measure of performance calculated in accordance with GAAP; as a result it should be viewed as a supplement to and not a substitute for our results of operations presented on the basis of GAAP. Management believes



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

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

***Three months ended June 30, 2006 compared to the three months ended June 30, 2005***

**STATION OPERATING INCOME.** SOI decreased \$0.2 million or 1.1% to \$19.9 million for the quarter ended June 30, 2006 from \$20.1 million for the same quarter of the prior year. As a percentage of net broadcasting revenue, SOI decreased to 37.2% for the quarter ended June 30, 2006 from 39.7% for the same quarter of the prior year. On a same station basis, SOI remained flat at \$20.1 million for the quarter ended June 30, 2006 and for the same quarter of the prior year. As a percentage of same station net broadcasting revenue, same station SOI decreased to 39.1% for the quarter ended June 30, 2006 from 40.3% for the same quarter of the prior year.

***Six months ended June 30, 2006 compared to the six months ended June 30, 2005***

**STATION OPERATING INCOME.** SOI decreased \$0.6 million or 1.7% to \$37.0 million for the six months ended June 30, 2006 from \$37.6 million for the same period of the prior year. As a percentage of net broadcasting revenue, SOI decreased to 36.2% for the six months ended June 30, 2006 from 38.5% for the same period of the prior year. On a same station basis, SOI decreased \$0.1 million or 0.1% to \$37.6 million for the six months ended June 30, 2006 from \$37.7 million for the same period of the prior year. As a percentage of same station net broadcasting revenue, same station SOI decreased to 38.5% for the six months ended June 30, 2006 from 39.2% for the same period of the prior year.

The following table provides a reconciliation of SOI (a non-GAAP financial measure) to operating income (as presented in our financial statements) for the quarters ended June 30, 2005 and 2006:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	2005	2006	2005	2006
	(Dollars in thousands)			
	\$		\$	
Station operating income	20,110	\$ 19,883	37,590	\$ 36,963
Plus non-broadcast revenue	2,740	4,684	5,168	7,936
Less non-broadcast operating expenses	(2,494)	(3,827)	(4,871)	(7,259)
Less depreciation and amortization	(3,355)	(3,866)	(6,606)	(7,161)
Plus gain (loss) on disposal of assets	(55)	15,510	(15)	19,039
Less corporate expenses	(4,936)	(6,256)	(9,983)	(12,696)
Less litigation costs	(650)		(650)	
	\$		\$	
Operating income	11,360	\$ 26,128	20,633	\$ 36,822

**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

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

station and network assets, goodwill and other intangible assets, income taxes, and long-term debt and debt covenant compliance. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

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

A majority of our radio station acquisitions are acquisitions of selected assets and not acquisitions of businesses. Such asset acquisitions have consisted primarily of the FCC licenses to broadcast in a particular market. We often do

not acquire the existing format, or we change the format upon acquisition when we find it beneficial. As a result, a substantial portion of the purchase price for the assets of a radio station is allocated to the FCC license. It is our policy generally to retain third-party appraisers to value radio stations, networks or non-broadcast properties. The allocations assigned to acquired FCC licenses and other assets are subjective by their nature and require our careful consideration and judgment. We believe the allocations represent appropriate estimates of the fair value of the assets acquired. As part of the valuation and appraisal process, the third-party appraisers prepare reports which assign values to the various asset categories in our financial statements. Our management reviews these reports and determines the reasonableness of the assigned values used to record the acquisition of the radio station, network or non-broadcast properties at the close of the transaction.

We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC licenses. Our policy is to capitalize costs incurred up to the point where the project is complete, at which time we transfer the costs to the appropriate fixed asset and/or intangible asset categories. When a project's completion 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, 2005, 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 result in impairment charges.

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

For financial reporting purposes, the company has recorded a valuation allowance of \$4.6 million as of June 30, 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. As of June 30, 2006, we were and remain in compliance with all of our debt covenants.

### ***Stock-Based Compensation***

Beginning in fiscal year 2006, the Company accounts for share-based compensation arrangements in accordance with the provisions of SFAS No. 123R, *Share-Based Payments*, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. The Company uses the Black-Scholes option valuation model to estimate the fair value of its stock options at the date of grant. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. The Company's employee stock options, however, have characteristics significantly different from those of traded options. For example, employee stock options are generally subject to vesting restrictions and are generally not transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility, the expected life of an option and the number of awards ultimately expected to vest. Changes in subjective input assumptions can materially affect the fair value estimates of an option. Furthermore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by an employee. The Company uses historical data to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. If actual results are not consistent with the Company's assumptions and judgments used in estimating the key assumptions, the Company may be required to increase or decrease compensation expense or income tax expense, which could be material to its results of operations.

In accordance with SFAS No. 123R, the Company records compensation expense for stock awards based on the estimated fair value of the award on the date of grant. The estimated fair value is determined based on the closing price of the Company's common stock on the award date multiplied by the number of awards expected to vest. The number of awards expected to vest is based on the number of awards granted adjusted by estimated forfeiture rates. The total compensation cost is then recognized ratably over the vesting period. If actual forfeiture rates are not consistent with the Company's estimates, the Company may be required to increase or decrease compensation expenses in future periods.

### **LIQUIDITY AND CAPITAL RESOURCES**

We have historically financed acquisitions through borrowings, including borrowings under credit facilities, and, to a lesser extent, from operating cash flow and selected asset dispositions. We expect to fund future acquisitions from cash on hand, proceeds from debt and equity offerings, borrowings under the credit facilities, operating cash flow and possibly through the sale of 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 June 30, 2006. We had a negative working capital of \$67.7 million on June 30, 2006 as a result of reclassifying our 9% notes to current due to the redemption of our 9% notes on

July 6, 2006. We had positive working capital of \$35.4 million for the same period of the prior year. During the six months ended June 30, 2006, we made net borrowings of \$33.0 million under our credit facilities and used \$29.7 million to acquire selected assets of five radio stations, three Internet business and two magazine businesses.

Net cash provided by operating activities decreased to \$18.2 million for the six months ended June 30, 2006 compared to \$19.2 million for the same period of the prior year, primarily due to an increase in income from continuing operations of \$7.2 million offset by the gain on asset disposals of \$19.1 million and an increase in accounts payables and accrued liabilities of \$2.6 million.

Net cash used in investing activities decreased to \$39.1 million for the for the six months ended June 30, 2006 compared to \$50.7 million for the same period of the prior year. The decrease is primarily due to cash used for acquisitions of \$29.7 during the first half of 2006 to purchase five radio stations, three Internet businesses and two magazine businesses compared to \$43.7 million used during the same period of the prior year to purchase four radio stations and one Internet business..

Net cash provided by financing activities was \$17.9 million for the six months ended June 30, 2006 compared to \$26.7 million for the same period of the prior year. The change was primarily due to increased stock repurchases of \$11.4 million during the first half of 2006 compared to the same period of the prior year and proceeds of \$3.7 million from our interest rate swap termination proceeds during the same period of the prior year.

*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 June 30, 2006, the borrowing capacity and aggregate commitments was \$75.0 million under our revolving credit facility, \$73.9 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 June 30, 2006, we could borrow \$65.9 million under our credit facilities.

At June 30, 2006, \$73.9 million was outstanding under the term loan B facility, \$50.0 million was outstanding under the term loan C facility and \$39.6 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 June 30, 2006, the blended interest rate on amounts outstanding under the credit facilities was 6.33%.

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 June 30, 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 June 30, 2006, on a pro forma basis, was 5.66 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 29, 2008 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, 2009, at which point it will remain at 4.0 to 1 through the remaining term of the credit facilities), and minimum fixed charge coverage (a static ratio of not less than 1.1 to 1). Salem and all of its subsidiaries, except for Salem Holding, are guarantors of borrowings under the credit facilities. The credit facilities are secured by liens on all of our assets and our subsidiaries' assets and pledges of all of the capital stock of our subsidiaries.

As of June 30, 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). 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 June 30, 2006, there was no outstanding balance under the Swingline.

As of June 30, 2006, we were and remain in compliance with all of the covenants under the terms of the Swingline.

*9% Notes.* In September 2001, Salem Holding issued \$150.0 million principal amount of 9% Notes. The indenture for the 9% 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. During the second quarter of 2004, Salem completed the redemption of \$55.6 million of the 9% Notes, leaving \$94.4 million outstanding. After giving effect to the redemption, Salem Holding is required to pay \$8.5 million per year in interest on the outstanding 9% Notes. We and all of our subsidiaries (other than Salem Holding) are guarantors of the 9% Notes.

As of June 30, 2006, we were in compliance with all of the covenants under the indenture for the 9% Notes.

On July 6, 2006, we redeemed the remainder of our 9% senior subordinated notes due July 2011 through a borrowing on our term loan C facility. The redemption price, as set forth in the notes, of 104.5% of the principal price, will result in a loss on early retirement of approximately \$3.6 million to be reported in the quarter ended September 30, 2006, which includes the write-off of unamortized bond issue costs and interest rate swap settlement amounts.

*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 June 30, 2006, we were and remain in compliance with all of the covenants under the indenture for the 7¾% Notes.

**Summary of long-term debt obligations**

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

	December 31, 2005	June 30, 2006
	<i>(Dollars in thousands)</i>	
Term loan under credit facility	\$ 123,875	\$ 123,875
Revolving line of credit under credit facility	6,600	39,600
Swingline credit facility		
7¾% senior subordinated notes due 2010	100,000	100,000
9% senior subordinated notes due 2011 (1)	96,664	96,412
Fair market value of interest rate swap agreement	215	
Capital leases and other loans	142	126
	327,496	360,013
Less current portion	(811)	(94,840)
	\$ 326,685	\$ 265,173

(1) Includes \$2,633 and \$2,381 as of December 31, 2005 and June 30, 2006, respectively, of fair value adjustments related to a terminated interest rate swap. The principal amount outstanding was \$94,031 as of December 31, 2005 and June 30, 2006.

**Off-balance sheet arrangements**

At June 30, 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.

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

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

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

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 our \$94.4 million 9% Notes. This agreement was scheduled to expire in 2011 when the 9% Notes were scheduled 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 being

amortized as a reduction of interest expense over the remaining life of the 9% Notes. Interest expense for the three and six months ended June 30, 2006 was reduced by \$0.2 and \$0.3 million, respectively, related to the amortization of the buyout premium received. Because this fair value hedge was effective (that is, the change in the fair value of the hedge instrument was designed to be equal to the change in the fair value of the item being hedged), there was no income statement effect relative to the change in the fair value of the swap agreement. Interest expense for the three months ended March 31, 2005, was reduced by \$0.3 million as a result of the difference between the 9.0% fixed interest rate on the 9% hedged debt and the floating interest rate under the swap agreement, which was 5.88% from January 1, 2005 through February 18, 2005.

On April 8, 2005, we entered into a forward-looking interest rate swap arrangement for the notional principal amount of \$30.0 million whereby it will pay a fixed interest rate of 4.99% as compared to LIBOR on a future bank credit facility borrowing. As of June 30, 2006, we recorded an asset for the fair value of the interest swap of approximately \$0.9 million. This amount, net of income tax benefits of approximately \$0.3 million, is reflected in other comprehensive income, as we designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap is July 1, 2006 and the expiration date is July 1, 2012.

On April 26, 2005, we entered into a second forward-looking interest rate swap arrangement for the notional principal amount of \$30.0 million whereby it will pay a fixed interest rate of 4.70% as compared to LIBOR on a future bank credit facility borrowing. As of June 30, 2006, we recorded an asset for the fair value of the interest swap of approximately \$1.3 million. This amount, net of income taxes of approximately \$0.5 million, is reflected in other comprehensive income, as we designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap is July 1, 2006 and the expiration date is July 1, 2012.

On May 5, 2005, we entered into a third forward-looking interest rate swap arrangement for the notional principal amount of \$30.0 million whereby it will pay a fixed interest rate of 4.53% as compared to LIBOR on a future bank credit facility borrowing. As of June 30, 2006, we recorded an asset for the fair value of the interest swap of approximately \$1.6 million. This amount, net of income taxes of approximately \$0.6 million, is reflected in other comprehensive income, as we designated the interest rate swap as a cash flow hedge. The effective date of this interest rate swap is July 1, 2006 and the expiration date is July 1, 2012.

## 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 June 30, 2006, we had borrowed \$163.5 million under the credit facilities. As of June 30, 2006, we could borrow up to an additional \$65.9 million under the credit facilities. Amounts outstanding under the credit facilities bear interest at a base rate, at our option, of the banks prime rate or LIBOR, plus a spread. For purposes of determining the interest rate under the revolving credit facilities, the prime rate spread ranges from 0.25% to 1.75%, and the LIBOR spread ranges from 1.5% to 3.0%. As of June 30, 2006, the blended interest rate on amounts outstanding under the credit facilities was 6.33%. At June 30, 2006, a hypothetical 100 basis point increase in the prime rate or LIBOR, as applicable, would result in additional interest expense of \$1.6 million on an annualized basis.

In addition to the variable rate debt disclosed above, we have fixed rate debt with a carrying value of \$194.0 million (relating to the outstanding 9% Notes and the 7¾% Notes) as of June 30, 2006, with an aggregate fair value of \$197.5 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 \$190.2 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 \$205.2 million.

**ITEM 4. CONTROLS AND PROCEDURES**

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

Officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

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

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

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

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 us, our directors, certain of our 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 provides for a full settlement of these claims in exchange for payment of \$1.85 million to be paid by the company and its insurance carrier. The settlement is subject to certain conditions set forth in the stipulation. 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 1A. RISK FACTORS**

The Company has included in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2005, a description of certain risks and uncertainties that could affect the Company's business, future performance or financial condition (the Risk Factors). The Risk Factors are hereby incorporated in Part II, Item 1A of this Form 10-Q. Investors should consider the Risk Factors prior to making an investment decision with respect to the Company's stock.

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

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

At the Annual Meeting of Stockholders of the Company held on May 24, 2006, the following matters were submitted to a vote of stockholders:



A. Election of the following nominees as directors of the company:

1. Stuart W. Epperson was elected by a vote of 73,950,144 for, with 299,329 withheld;  
Edward G. Atsinger III was elected by a vote
2. of 73,950,144 for, with 294,489 withheld;
3. David Davenport was elected by a vote of 18,413,184 for, with 376,766 withheld;

4. Eric H. Halvorson was elected by a vote of 73,950,144 for, with 853,005 withheld;
5. Roland S. Hinz was elected by a vote of 73,950,144 for, with 381,766 withheld;
6. Paul Pressler was elected by a vote of 18,413,184 for, with 121,427 withheld;
7. Richard A. Riddle was elected by a vote of 73,950,144 for, with 376,766 withheld; and
8. Dennis M. Weinberg was elected by a vote of 73,950,144 for, with 250,800 withheld.

B. To approve an amendment to the Company's Amended and Restated 1999 Stock Incentive Plan (the Plan) to: (a) eliminate the requirement that the re-pricing of options issued under the Plan be approved by the duly authorized vote of a majority all outstanding Company shares, and (b) permit the Company to make loans to qualified persons granted options under the Plan for the purpose of exercising granted options:

3,398,465 for, with 69,911,244 against, 2,500 abstaining and 637,935 broker no votes.

C. To re-approve the provision in the Plan establishing the maximum number of shares of Class A common stock available under awards to a single participant in any one calendar year at 100,000:

72,573,993 for, with 737,316 against, 900 abstaining and 637,935 broker no votes.

D. To ratify the appointment of Ernst & Young, LLP as the Company's independent registered public accounting firm for the fiscal year ended December 31, 2006:

73,626,886 for, 321,684 against and 1,574 abstaining.

The total number of shares of Class A common stock outstanding as of March 30, 2006, the record date for the Annual Meeting, was 18,793,824, the total number of shares of Class B common stock outstanding as of that date was 5,553,696. Each share of Class A common stock is entitled to one vote per share, and each share of Class B common stock is entitled to ten votes per share.

## ITEM 5. OTHER INFORMATION

Not applicable. .

## ITEM 6. EXHIBITS

Set forth below is a list of exhibits included as part of this Quarterly Report:

### INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Form	File No.	Incorporated by Reference		Exhibit Number	Filed Herewith
				First Filing	Date of		
3.01	Amended and Restated Certificate of Incorporation of Salem Communications Corporation, a Delaware corporation.	8-K	333-41733-29	04/14/99		3.1	
3.02	Bylaws of Salem Communications Corporation, a Delaware Corporation.	8-K	333-41733-29	04/14/99		3.2	
3.03	Certificate of Incorporation of Salem Communications Holding Corporation.	8-K	000-26497	09/08/00		2.01	

3.04	Bylaws of Salem Communications Holding Corporation.	<b>8-K</b>	<b>000-26497</b>	<b>09/08/00</b>	<b>2.02</b>
3.05	Certificate of Incorporation of Salem Communications Acquisition Corporation.	<b>8-K</b>	<b>000-26497</b>	<b>09/08/00</b>	<b>2.03</b>
3.06	Bylaws of Salem Communications Acquisition Corporation.	<b>8-K</b>	<b>000-26497</b>	<b>09/08/00</b>	<b>2.04</b>
3.07	Certificate of Incorporation of SCA License Corporation.	<b>8-K</b>	<b>000-26497</b>	<b>09/08/00</b>	<b>2.05</b>
3.08	Bylaws of SCA License Corporation.	<b>8-K</b>	<b>000-26497</b>	<b>09/08/00</b>	<b>2.06</b>
4.01	Specimen of Class A common stock certificate.	<b>S-1/A</b>	<b>333-76649</b>	<b>Declared Effective 06/30/99</b>	<b>4.09</b>
4.02	Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, Suntrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	<b>10-Q</b>	<b>000-26497</b>	<b>11/06/03</b>	<b>4.09</b>



4.03	Second Amended and Restated Parent Security Agreement dated as of June 15, 2001, by and among Salem Communications Corporation, a Delaware corporation, Salem Communications Holding Corporation, a Delaware corporation, and The Bank of New York, as Administrative Agent.	<b>10-Q</b>	<b>000-26497</b>	<b>08/14/01</b>	<b>4.24.02</b>
4.04	Amendment #1, dated as of May 19, 2004, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, Suntrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	<b>10-Q</b>	<b>000-26497</b>	<b>08/06/04</b>	<b>4.11</b>

4.05	Amendment #2, dated as of July 7, 2005, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, Suntrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	<b>8-K</b>	<b>000-26497</b>	<b>07/13/05</b>	<b>4.12</b>
4.06	Indenture between Salem Communications Holding Corporation, a Delaware corporation, certain named guarantors and The Bank of New York, as Trustee, dated as of June 25, 2001, relating to the 9% Series A and Series B Senior Subordinated Notes due 2011.	<b>10-Q</b>	<b>000-26497</b>	<b>08/14/01</b>	<b>4.10.03</b>
4.07	Form of 9% Senior Subordinated Notes (filed as part of exhibit 4.06).	<b>10-Q</b>	<b>000-26497</b>	<b>08/14/01</b>	
4.08	Form of Note Guarantee (filed as part of exhibit 4.06).	<b>10-Q</b>	<b>000-26497</b>	<b>08/14/01</b>	

4.09	Registration Rights Agreement dated as of June 25, 2001, by and among Salem Communications Holding Corporation, the guarantors and initial purchasers named therein.	<b>10-Q</b>	<b>000-26497</b>	<b>08/14/01</b>	<b>4.28</b>
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4.10	Indenture, dated as of December 23, 2002, relating to the 7¾% Senior Subordinated Notes due 2010 by and among Salem Holding, the Company and The Bank of New York, as trustee, with form of Note incorporated	<b>8-K</b>	<b>000-26497</b>	<b>12/23/02</b>	<b>4.1</b>
4.11	Form of 7¾% Senior Subordinated Notes (filed as part of exhibit 4.10).	<b>8-K</b>	<b>000-26497</b>	<b>12/23/02</b>	
4.12	Form of Note Guarantee (filed as part of exhibit 4.10).	<b>8-K</b>	<b>000-26497</b>	<b>12/23/02</b>	
4.13	Supplemental Indenture No. 1 to the 7¾% Senior Subordinated Notes, dated as of December 23, 2002, between Salem Communications Corporation and its guarantors, and Bank of New York.	<b>10-K</b>	<b>000-26497</b>	<b>03/31/03</b>	<b>4.22</b>
4.14	Supplemental Indenture No. 1 to the 9% Senior Subordinated Notes, dated as of December 16, 2002, between Salem Communications Corporation and its guarantors, and Bank of New York.	<b>10-K</b>	<b>000-26497</b>	<b>03/31/03</b>	<b>4.23</b>
4.15	Supplemental Indenture No. 2 to the 7¾% Senior Subordinated Notes, dated as of June 12, 2003, between Salem Communications Corporation and its guarantors, and Bank of New York.	<b>10-Q</b>	<b>000-26497</b>	<b>08/06/03</b>	<b>4.24</b>

4.16	Supplemental Indenture No. 2 to the 9% Senior Subordinated Notes, dated as of June 12, 2003, between Salem Communications Corporation and its guarantors, and Bank of New York.	<b>10-Q</b>	<b>000-26497</b>	<b>08/06/03</b>	<b>4.25</b>
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4.17	Consent No. 2, dated as of July 23, 2003, under the Fourth Amended and Restated Credit Agreement between Salem Communications Corporation and its guarantors, and The Bank of New York.	<b>10-Q</b>	<b>000-26497</b>	<b>08/06/03</b>	<b>4.26</b>
4.18	Amendment #3, dated as of June 9, 2006, to the Fifth Amended and Restated Credit Agreement, dated as of September 25, 2003, by and among Salem Communications Corporation, Salem Communications Holding Corporation, General Electric Capital Corporation, as Syndication Agent, Suntrust Bank, as Syndication Agent, Fleet National Bank, as Documentation Agent, ING (U.S.) Capital, LLC, as Documentation Agent, The Bank of New York, as Administrative Agent, and the Lenders party thereto.	<b>8-K</b>	<b>000-26497</b>	<b>06/15/06</b>	<b>4.13</b>
10.01.01	Employment Agreement, dated July 1, 2004, between Salem Communications Holding Corporation and Edward G. Atsinger III.	<b>10-Q</b>	<b>000-26497</b>	<b>08/06/04</b>	<b>10.01.01</b>
10.02.01	Employment Agreement, dated July 1, 2004, between Salem Communications Holding Corporation	<b>10-Q</b>	<b>000-26497</b>	<b>08/06/04</b>	<b>10.02.01</b>

and Stuart W.  
Epperson.

10.04 Employment  
Agreement, dated  
September 16, 2003,  
between Salem  
Communications           **10-Q**   **000-26497**   **11/06/03**   **10.04**  
Holding Corporation  
and David A.R. Evans.

10.04.01	Employment Agreement, effective as of September 1, 2005, between Salem Communications Holding Corporation and David A.R. Evans.	<b>8-K</b>	<b>000-26497</b>	<b>09/27/05</b>	<b>99.1</b>
10.04.02	Employment Agreement, effective as of September 1, 2005, between Salem Communications Holding Corporation and Joe D. Davis	<b>8-K/A</b>	<b>000-26497</b>	<b>05/25/05</b>	<b>99.1</b>
10.05.04	Antenna/tower/studio lease between Common Ground Broadcasting, Inc. (KKMS-AM/Eagan, Minnesota) and Messrs. Atsinger and Epperson expiring in 2016.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.04</b>
10.05.05	Antenna/tower lease between Common Ground Broadcasting, Inc. (WHK-AM/Cleveland, Ohio) and Messrs. Atsinger and Epperson expiring 2008.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.05</b>
10.05.06	Antenna/tower lease (KFAX-FM/Hayward, California) and Salem Broadcasting Company, a partnership consisting of Messrs. Atsinger and Epperson, expiring in 2013.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.06</b>
10.05.08	Antenna/tower lease between Inspiration Media, Inc. (KGNW-AM/Seattle, Washington) and Messrs. Atsinger and Epperson expiring in	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.08</b>

2012.

10.05.09	Antenna/tower lease between Inspiration Media, Inc. (KLFE-AM/Seattle, Washington) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring in 2014.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.09</b>
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10.05.11.01	Antenna/tower/studio lease between Pennsylvania Media Associates, Inc. (WNTP-AM/WFIL-AM/Philadelphia, Pennsylvania) and Messrs. Atsinger and Epperson, as assigned from WEAZ-FM Radio, Inc., expiring 2004.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.11.01</b>
10.05.11.02	Antenna/tower/studio lease between Pennsylvania Media Associates, Inc. (WNTP-AM/WFIL-AM/Philadelphia, Pennsylvania) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2014.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.11.02</b>
10.05.12	Antenna/tower lease between New Inspiration Broadcasting Co., Inc.: as successor in interest to Radio 1210, Inc. (KPRZ-AM/Olivenhain, California) and The Atsinger Family Trust expiring in 2028.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.12</b>
10.05.13	Antenna/tower lease between Salem Media of Texas, Inc. and Atsinger Family Trust/Epperson Family Limited Partnership (KSLR-AM/San Antonio, Texas).	<b>10-K</b>	<b>000-26497</b>	<b>03/30/00</b>	<b>10.05.13</b>
10.05.15	Antenna/tower lease between Salem Media of Colorado, Inc. (KNUS-AM/Denver-Boulder, Colorado) and Messrs. Atsinger and Epperson expiring 2016.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.15</b>

10.05.16	Antenna/tower lease between Salem Media of Colorado, Inc. and Atsinger Family Trust/Epperson Family Limited Partnership (KRKS-AM/KBJD-AM/Denver, Colorado).	<b>10-K</b>	<b>000-26497</b>	<b>03/30/00</b>	<b>10.05.16</b>
10.05.17.02	Antenna/tower lease between Salem Media of Oregon, Inc. (KPDQ-AM/FM/Raleigh Hills, Oregon), and Messrs. Atsinger and Epperson expiring 2012.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.17.02</b>
10.05.18	Antenna/tower lease between Salem Media of Pennsylvania, Inc. (WORD-FM/WPIT-AM/Pittsburgh, Pennsylvania) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2013.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.18</b>
10.05.19	Antenna/tower lease between Salem Media of Texas, Inc. (KSLR-AM/San Antonio, Texas) and Epperson-Atsinger 1983 Family Trust expiring 2017.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.19</b>
10.05.20	Antenna/tower lease between South Texas Broadcasting, Inc. (KNTH-AM/Houston-Galveston, Texas) and Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2015.	<b>S-4</b>	<b>333-41733-29</b>	<b>01/29/98</b>	<b>10.05.20</b>
10.05.21	Antenna/tower lease between New Inspiration Broadcasting Co., Inc. successor in interest to Vista Broadcasting, Inc. (KFIA-AM/Sacramento, California) and The Atsinger Family Trust and Stuart W. Epperson Revocable Living Trust expiring 2016.	<b>S-4</b>	<b>333-41733-29</b>	<b>10/29/98</b>	<b>10.05.21</b>



10.05.22	Antenna/tower lease between South Texas Broadcasting, Inc. (KKHT-FM/Houston-Galveston, Texas) and Sonsinger Broadcasting Company of Houston, LP expiring 2008.	<b>10-K 405</b>	<b>000-26497</b>	<b>03/31/99</b>	<b>10.05.22</b>
10.05.23	Antenna/tower lease between Inspiration Media of Texas, Inc. (KTEK-AM/Alvin, Texas) and the Atsinger Family Trust and The Stuart W. Epperson Revocable Living Trust expiring 2018.	<b>10-K 405</b>	<b>000-26497</b>	<b>03/31/99</b>	<b>10.05.23</b>
10.05.24	Studio building lease between Salem Radio Properties, Inc. and Thomas H. Moffit Jr.	<b>10-K</b>	<b>000-26497</b>	<b>03/31/06</b>	<b>10.05.24</b>
10.05.25	Antenna/tower lease between Pennsylvania Media Associates Inc. (WLTN-AM/ Orlando, Florida) and Atsinger Family Trust and Stuart W. Epperson, revocable living trust expiring 2045.	<b>10-K</b>	<b>000-26497</b>	<b>03/31/06</b>	<b>10.05.25</b>
10.06	Asset Purchase Agreement, dated June 2002, by and between Caron Broadcasting, Inc. and Susquehana Radio Corp. (WYGY-FM, Cincinnati, OH).	<b>10-Q</b>	<b>000-26497</b>	<b>08/14/02</b>	<b>10.08.14</b>
10.08.01	Amended and Restated 1999 Stock Incentive Plan (incorporated by reference to previously filed Appendix B).	<b>DEF 14A</b>	<b>000-26497</b>	<b>04/29/03</b>	<b>Appendix B</b>
10.08.02	Form of stock option grant for Amended and Restated 1999 Stock Incentive Plan.	<b>10-K</b>	<b>000-26497</b>	<b>03/16/05</b>	<b>10.08.02</b>
10.08.03	Form of restricted stock option grant for Amended and Restated 1999 Stock Incentive Plan.	<b>10-Q</b>	<b>000-26497</b>	<b>11/09/05</b>	<b>10.01</b>
10.08.04	Amended and Restated 1999 Stock Incentive Plan as amended and restated through May 18, 2005.	<b>DEF 14A</b>	<b>000-26497</b>	<b>04/18/05</b>	<b>Proposal No. 2</b>



10.09	Management Services Agreement by and among Salem and Salem Communications Holding Corporation, dated August 25, 2000 (incorporated by reference to previously filed exhibit 10.11). (7)	<b>10-Q</b>	<b>000-26497</b>	<b>05/15/01</b>	<b>10.11</b>	
23.1	Consent of Ernst & Young, Independent Registered Public Accounting Firm.	<b>10-K</b>	<b>000-26497</b>	<b>03/31/06</b>	<b>23.1</b>	
31.1	Certification of Edward G. Atsinger III Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.	-	-	-	-	<b>X</b>
31.2	Certification of David A.R. Evans Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.	-	-	-	-	<b>X</b>
32.1	Certification of Edward G. Atsinger III Pursuant to 18 U.S.C. Section 1350.	-	-	-	-	<b>X</b>
32.2	Certification of David A.R. Evans Pursuant to 18 U.S.C. Section 1350.	-	-	-	-	<b>X</b>

**SIGNATURES**

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

SALEM COMMUNICATIONS CORPORATION

August 9, 2006

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

August 9, 2006

By: /s/ DAVID A.R. EVANS  
David A.R. Evans  
Executive Vice President - Business Development and  
Chief Financial Officer  
(Principal Financial Officer)

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
31.1	Certification of Edward G. Atsinger III Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.
31.2	Certification of David A.R. Evans Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act.
32.1	Certification of Edward G. Atsinger III Pursuant to 18 U.S.C. Section 1350.
32.2	Certification of David A.R. Evans Pursuant to 18 U.S.C. Section 1350.

EXHIBIT 31.1

**Certification of Chief Executive Officer**

I, Edward G. Atsinger III, certify that:

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

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 9, 2006

By: /s/ EDWARD G. ATSINGER III

Edward G. Atsinger III

Chief Executive Officer

**EXHIBIT 31.2**

**Certification of Chief Financial Officer**

I, David A.R. Evans, certify that:

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



- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 9, 2006

By: /s/ DAVID A.R.  
EVANS

David A.R. Evans

Executive Vice President - Business Development and Chief Financial Officer

**EXHIBIT 32.1**

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

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

•

the Quarterly Report of the Company on Form 10-Q for the period ended March 31, 2006 (the Report) fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and

•

the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 9, 2006

By: /s/ EDWARD G. ATSINGER III

Edward G. Atsinger III

President and Chief Executive Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906 has been provided to Salem Communications Corporation and will be retained by Salem Communications Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**EXHIBIT 32.2**

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

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

•

the Quarterly Report of the Company on Form 10-Q for the period ended March 31, 2006 (the Report) fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and

•

the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 9,  
2006

By: /s/ DAVID A.R. EVANS  
David A.R. Evans  
Executive Vice President - Business Development and  
Chief Financial Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906 has been provided to Salem Communications Corporation and will be retained by Salem Communications Corporation and furnished to the Securities and Exchange Commission or its staff upon request.