

SALEM COMMUNICATIONS CORP /DE/

Form 10-Q

November 07, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2014

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
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

93012
(ZIP CODE)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a Smaller Reporting Company) Smaller Reporting Company

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

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

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

Outstanding at November 3, 2014
19,716,740 shares

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

Outstanding at November 3, 2014
5,553,696 shares

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

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PART I FINANCIAL INFORMATION
SALEM COMMUNICATIONS CORPORATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

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

| | December 31, 2013 (Note 1) | September 30, 2014 (Unaudited) |
|---|-------------------------------|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 65 | \$ 311 |
| Trade accounts receivable (net of allowance for doubtful accounts of \$10,809 in 2013 and \$14,398 in 2014) | 37,627 | 40,168 |
| Other receivables | 720 | 3,332 |
| Inventories (net of reserves of \$2,748 in 2014) | | 626 |
| Prepaid expenses | 4,049 | 6,396 |
| Deferred income taxes | 6,876 | 6,876 |
| Assets held for sale | 1,700 | 1,700 |
| Assets of discontinued operations | 8 | |
| Total current assets | 51,045 | 59,409 |
| Notes receivable (net of allowance of \$548 in 2013 and \$1,022 in 2014) | 1,866 | 313 |
| Fair value of interest rate swap | 3,177 | 1,754 |
| Property, plant and equipment (net of accumulated depreciation of \$145,215 in 2013 and \$153,295 in 2014) | 98,928 | 100,296 |
| Broadcast licenses | 381,836 | 385,554 |
| Goodwill | 22,374 | 24,727 |
| Other indefinite-lived intangible assets | 868 | 868 |
| Amortizable intangible assets (net of accumulated amortization of \$27,933 in 2013 and \$32,600 in 2014) | 8,793 | 13,903 |
| Deferred financing costs | 4,130 | 3,628 |
| Other assets | 2,096 | 2,100 |
| Total assets | \$ 575,113 | \$ 592,552 |

LIABILITIES AND STOCKHOLDERS EQUITY

| | | |
|---|----------|----------|
| Current liabilities: | | |
| Accounts payable | \$ 3,960 | \$ 5,252 |
| Accrued expenses | 7,888 | 13,324 |
| Accrued compensation and related expenses | 6,913 | 8,649 |
| Accrued interest | 37 | 45 |
| Deferred revenue | 9,721 | 12,409 |
| Income tax payable | 142 | 169 |
| Current portion of long-term debt and capital lease obligations | 3,121 | 2,871 |

| | | |
|--|------------|-------------------|
| Total current liabilities | 31,782 | 42,719 |
| Long-term debt and capital lease obligations, less current portion | 287,672 | 283,506 |
| Deferred income taxes | 43,457 | 46,590 |
| Deferred revenue | 9,965 | 10,452 |
| Other liabilities | 452 | 4,151 |
| Total liabilities | 373,328 | 387,418 |
| Commitments and contingencies (Note 16) | | |
| Stockholders' equity: | | |
| Class A common stock, \$0.01 par value; authorized 80,000,000 shares; 21,803,303 and 22,030,640 issued and 19,485,653 and 19,712,990 outstanding at December 31, 2013 and September 30, 2014, respectively | 218 | 220 |
| Class B common stock, \$0.01 par value; authorized 20,000,000 shares; 5,553,696 issued and outstanding at December 31, 2013 and September 30, 2014, respectively | 56 | 56 |
| Additional paid-in capital | 237,579 | 240,026 |
| Accumulated deficit | (2,062) | (1,162) |
| Treasury stock, at cost (2,317,650 shares at December 31, 2013 and September 30, 2014) | (34,006) | (34,006) |
| Total stockholders' equity | 201,785 | 205,134 |
| Total liabilities and stockholders' equity | \$ 575,113 | \$ 592,552 |

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|------------------|--------------------------|-------------------|
| | September 30, | | September 30, | |
| | 2013 | 2014 | 2013 | 2014 |
| Net broadcast revenue | \$ 46,015 | \$ 46,962 | \$ 136,287 | \$ 140,393 |
| Net Internet revenue | 9,390 | 14,511 | 29,012 | 41,811 |
| Net publishing revenue | 3,071 | 8,130 | 8,941 | 18,369 |
| Total net revenue | 58,476 | 69,603 | 174,240 | 200,573 |
| Operating expenses: | | | | |
| Broadcast operating expenses exclusive of depreciation and amortization shown below (including \$358 and \$364 for the three months ended September 30, 2013 and 2014, respectively, and \$1,069 and \$1,087 for the nine months ended September 30, 2013 and 2014, respectively, paid to related parties) | 30,847 | 32,596 | 91,258 | 97,695 |
| Internet operating expenses exclusive of depreciation and amortization shown below | 6,644 | 10,931 | 20,372 | 30,811 |
| Publishing operating expenses exclusive of depreciation and amortization shown below | 3,301 | 6,766 | 9,776 | 17,624 |
| Corporate expenses exclusive of depreciation and amortization shown below (including \$79 and \$35 for the three months ended September 30, 2013 and 2014, respectively, and \$239 and \$211 for the nine months ended September 30, 2013 and 2014, respectively, paid to related parties) | 4,951 | 5,254 | 15,839 | 17,542 |
| Depreciation | 3,089 | 3,141 | 9,313 | 9,437 |
| Amortization | 695 | 1,530 | 2,076 | 4,667 |
| Change in the estimated fair value of contingent earn-out consideration | | 545 | | 914 |
| Impairment of indefinite-lived long-term assets other than goodwill | | | 345 | |
| Impairment of goodwill | | | 438 | |
| (Gain) loss on disposal of assets | (25) | (7) | (20) | 214 |
| Total operating expenses | 49,502 | 60,756 | 149,397 | 178,904 |

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| | | | | |
|--|------------|-------------------|------------|-------------------|
| Net operating income from continuing operations | 8,974 | 8,847 | 24,843 | 21,669 |
| Other income (expense): | | | | |
| Interest income | 16 | 2 | 52 | 43 |
| Interest expense including \$0 and \$154, respectively, for the three and nine months ended | | | | |
| September 30, 2013, paid to related parties | (3,770) | (4,139) | (13,212) | (11,986) |
| Change in fair value of interest rate swap | (1,033) | 1,046 | 2,545 | (1,423) |
| Loss on early retirement of long-term debt | (16) | (18) | (27,792) | (26) |
| Net miscellaneous income and expenses | 4 | 572 | 15 | 652 |
| Net income (loss) from continuing operations before income taxes | 4,175 | 6,310 | (13,549) | 8,929 |
| Provision for (benefit from) income taxes | (1,159) | 2,567 | (5,506) | 3,492 |
| Net income (loss) from continuing operations | 5,334 | 3,743 | (8,043) | 5,437 |
| Loss from discontinued operations | (11) | | (26) | |
| Net income (loss) | \$ 5,323 | \$ 3,743 | \$ (8,069) | \$ 5,437 |
| Basic earnings per share data: | | | | |
| Earnings (loss) per share from continuing operations | \$ 0.21 | \$ 0.14 | \$ (0.32) | \$ 0.21 |
| Earnings (loss) per share from discontinued operations | | | | |
| Basic earnings (loss) per share | \$ 0.21 | \$ 0.14 | \$ (0.32) | \$ 0.21 |
| Diluted earnings per share data: | | | | |
| Earnings (loss) per share from continuing operations | \$ 0.21 | \$ 0.14 | \$ (0.32) | \$ 0.21 |
| Earnings (loss) per share from discontinued operations | | | | |
| Diluted earnings (loss) per share | \$ 0.21 | \$ 0.14 | \$ (0.32) | \$ 0.21 |
| Distributions per share | \$ | \$ 0.06 | \$ 0.10 | \$ 0.18 |
| Basic weighted average shares outstanding | 25,126,858 | 25,536,397 | 24,832,140 | 25,258,025 |
| Diluted weighted average shares outstanding | 25,921,391 | 26,265,957 | 24,832,140 | 26,032,789 |

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

| | Nine Months Ended | |
|--|--------------------------|----------|
| | September 30, | |
| | 2013 | 2014 |
| OPERATING ACTIVITIES | | |
| Net income (loss) from continuing operations | \$ (8,043) | \$ 5,437 |
| Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities: | | |
| Non-cash stock-based compensation | 1,529 | 1,276 |
| Tax benefit related to stock options exercised | 117 | 78 |
| Depreciation and amortization | 11,389 | 14,104 |
| Amortization of bank loan fees | 682 | 516 |
| Accretion of discount on Term Loan B | 148 | 141 |
| Accretion of acquisition-related deferred payments and contingent consideration | | 486 |
| Provision for bad debts | 2,490 | 2,186 |
| Deferred income taxes | (5,815) | 3,133 |
| Impairment of indefinite-lived long-term assets other than goodwill | 345 | |
| Impairment of goodwill | 438 | |
| Change in the fair value of interest rate swap | (2,545) | 1,423 |
| Change in the estimated fair value of contingent earn-out consideration | | 914 |
| Loss on early retirement of long-term debt | 27,792 | 26 |
| (Gain) loss on the sale or disposal of assets | (20) | 214 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1,717 | (1,476) |
| Prepaid expenses and other current assets | (860) | (588) |
| Accounts payable and accrued expenses | (3,756) | 4,035 |
| Deferred revenue | (4,148) | (4,218) |
| Other liabilities | (9) | (428) |
| Income taxes payable | (75) | 27 |
| Net cash provided by operating activities | 21,376 | 27,286 |
| INVESTING ACTIVITIES | | |
| Capital expenditures | (7,792) | (7,910) |
| Cash escrow deposits (paid) released related to acquisitions | 170 | (120) |
| Purchases of broadcast assets and radio stations | (5,000) | (4,570) |
| Purchases of Internet businesses and assets | (707) | (3,334) |
| Purchases of publishing businesses and assets | | (2,774) |
| Proceeds from the sale of assets | | 2 |

| | | |
|--|-----------|----------|
| Other | (117) | (271) |
| Net cash used in investing activities | (13,446) | (18,977) |
| FINANCING ACTIVITIES | | |
| Payments to redeem Terminated 9 ⁵ / ₈ % Notes | (213,500) | |
| Payment of bond premium in connection with early redemptions and repurchases of Terminated 9 ⁵ / ₈ % Notes | (22,677) | |
| Proceeds from borrowings under Term Loan | 298,500 | |
| Payments under Term Loan B | (8,000) | (7,250) |
| Proceeds from borrowings under Revolver | 20,512 | 44,656 |
| Payments under Revolver | (18,052) | (41,897) |
| Payments of costs related to bank credit facility | (4,384) | (14) |
| Proceeds from borrowings under terminated credit facilities and subordinated debt | 46,747 | |
| Payments under terminated credit facilities and subordinated debt | (87,220) | |
| Payments to Terminated Subordinated Debt due to Related Parties | (15,000) | |
| Payments of contingent earn-out consideration | | (300) |
| Proceeds from exercise of stock options | 978 | 1,095 |
| Payments of seller financed note | (2,000) | |
| Payments on capital lease obligations | (92) | (92) |
| Payment of cash distributions on common stock | (2,474) | (4,537) |
| Book overdraft | (196) | 276 |
| Net cash used in financing activities | (6,858) | (8,063) |

See accompanying notes

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SALEM COMMUNICATIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Dollars in thousands)

(Unaudited)

CASH FLOWS FROM DISCONTINUED OPERATIONS

| | | |
|--|----------|---------------|
| Operating cash flows | (26) | |
| Net cash outflows from discontinued operations | (26) | |
| Net increase in cash and cash equivalents | 1,046 | 246 |
| Cash and cash equivalents at beginning of year | 380 | 65 |
| Cash and cash equivalents at end of period | \$ 1,426 | \$ 311 |

Supplemental disclosures of cash flow information:

Cash paid during the period for:

| | | |
|---|-----------|------------------|
| Cash paid for interest, net of capitalized interest (including \$296 paid to related parties for the nine months ending September 30, 2013) | \$ 13,384 | \$ 10,804 |
| Cash paid for income taxes | \$ 250 | \$ 254 |

Other supplemental disclosures of cash flow information:

| | | |
|---------------|----------|-----------------|
| Trade revenue | \$ 4,250 | \$ 4,919 |
| Trade expense | \$ 3,300 | \$ 4,827 |

Non-cash investing and financing activities:

| | | |
|---|----------|-----------------|
| Seller financed note due directly to seller of station assets | \$ 2,000 | \$ |
| Present value of advertising credits payable | \$ 2,427 | \$ |
| Estimated present value of contingent earn-out consideration | \$ | \$ 2,047 |
| Deferred payments due 2014 under asset purchase agreement | \$ | \$ 300 |
| Present value of deferred cash payments (due 2015) | \$ | \$ 893 |
| Present value of deferred cash payments (due 2016) | \$ | \$ 2,289 |
| Assets acquired under capital leases | \$ 97 | \$ |

See accompanying notes

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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, we, us, our or the company) includes the company and all wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Information with respect to the three and nine months ended September 30, 2013 and 2014 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 unaudited interim financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Annual Report for Salem filed on Form 10-K for the year ended December 31, 2013. Our results are subject to seasonal fluctuations. Therefore, the results of operations for the interim periods presented are not necessarily indicative of the results of operations for the full year.

The balance sheet at December 31, 2013 included in this report has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP.

Description of Business

Salem is a diversified multi-media company with integrated business operations covering radio broadcasting, content programming, Internet portals and websites and book and magazine publishing. Our programming is intended for audiences interested in Christian and family-themed content and conservative news talk.

Our foundational business is the ownership and operation of radio stations in large metropolitan markets. Upon the close of all announced transactions, we will own and/or operate 105 radio stations throughout the United States. Our broadcasting business also includes Salem Radio Network® (SRN), SRN News Network (SNN), Salem Music Network (SMN), Solid Gospel Network (SGN), Salem Media Representatives (SMR) and Vista Media Representatives (VMR). SRN, SNN, SMN and SGN are networks that produce and distribute programming, such as talk, news and music segments, to radio stations throughout the United States, including Salem owned and operated stations. SMR and VMR sell commercial airtime to national advertisers on radio stations and networks that we own, as well as on independent radio station affiliates.

Internet and e-commerce has been a significant area of growth for Salem and continues to be a prime focus for our future development. Salem Web Network (SWN) and our other Internet businesses provide Christian and conservative-themed content, audio and video streaming, and other resources digitally through the web. SWN's Internet portals include Christian content websites: OnePlace.com, Christianity.com, Crosswalk.com®, GodVine.com, Jesus.org and BibleStudyTools.com. Our conservative opinion websites include Townhall.com and HotAir.com. Townhall.com also operates Twitchy.com and as of January 10, 2014, HumanEvents.com and RedState.com. All of

our digital content is accessible through our radio station websites that also promote local content of interest to our audiences throughout the United States.

Our Internet and e-commerce segment also operates church product websites including WorshipHouseMedia.com, SermonSpice.com and ChurchStaffing.com. We offer books, DVD s and editorial content developed by our on-air personalities through the Salem Consumer Products website. As of January 10, 2014, our Internet and e-commerce segment includes e-book sales through Regnery Publishing; distribution of digitally delivered newsletters featuring market analysis and investment advice through Eagle Financial Publications; and complimentary health advice and nutritional products through Eagle Wellness.

Our acquisition of Regnery Publishing on January 10, 2014, represents a major shift in our publishing segment. Regnery Publishing is a publisher of conservative books that was founded in 1947. Regnery has published dozens of bestselling books by leading conservative authors and personalities, including Ann Coulter, Newt Gingrich, Michelle Malkin, David Limbaugh, Ed Klein, Laura Ingraham, Mark Steyn and Dinesh D Souza. Our publishing segment also includes Salem Publishing , a producer and distributor of Christian and conservative opinion print magazines and Xulon Press , a print-on-demand self-publishing service for Christian authors.

Variable Interest Entities

We account for entities qualifying as variable interest entities (VIEs) in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810, *Consolidation* which requires VIEs to be consolidated by the primary beneficiary. The primary beneficiary is the entity that holds the majority of the beneficial interests in the VIE. A VIE is an entity for which the primary beneficiary s interest in the entity can change with variations in factors other than the amount of investment in the entity.

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We may enter into Local Marketing Agreements (LMA) contemporaneously with entering an Asset Purchase Agreement (APA) to acquire or sell a radio station. We may also enter into Time Brokerage Agreements (TBAs). Typically, both LMAs and TBAs are contractual agreements under which the station owner/licensee makes airtime available to a programmer/licensee in exchange for a fee and reimbursement of certain expenses. LMAs and TBAs are subject to compliance with the antitrust laws and the communications laws, including the requirement that the licensee must maintain independent control over the station and, in particular, its personnel, programming, and finances. The FCC has held that such agreements do not violate the communications laws as long as the licensee of the station receiving programming from another station maintains ultimate responsibility for, and control over, station operations and otherwise ensures compliance with the communications laws.

The requirements of FASB ASC Topic 810 may apply to entities under LMAs or TBAs, depending on the facts and circumstances related to each transaction. As of September 30, 2014 we did not consolidate any entities with which we entered into LMAs or TBAs under the guidance in FASB ASC Topic 810.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas for which management uses estimates include: (1) asset impairments, including broadcasting licenses, goodwill and other indefinite-lived intangible assets; (2) income tax valuation allowances; (3) uncertain tax positions; (4) allowance for doubtful accounts; (5) inventory reserves; (6) reserves for royalty advances; (7) self-insurance reserves; (8) fair value of equity awards; (9) estimated lives for tangible and intangible assets; (10) fair value measurements; (11) contingency reserves; (12) probabilities associated with the potential for contingent earn-out consideration; and (13) sales returns and allowances. These estimates require the use of judgment as future events and the effect of these events cannot be predicted with certainty. The estimates will change as new events occur, as more experience is acquired and as more information is obtained. We evaluate and update our assumptions and estimates on an ongoing basis and we may consult outside experts to assist as considered necessary.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

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

Approximately 69% of our total assets as of September 30, 2014 consist of indefinite-lived intangible assets, such as broadcast licenses, goodwill and mastheads, the value of which depends significantly upon the operating results of our businesses. In the case of our radio stations, we would not be able to operate the properties without the related FCC license for each property. Broadcast licenses are renewed with the FCC every eight years for a nominal cost that is expensed as incurred. We continually monitor our stations' compliance with the various regulatory requirements. Historically, all of our broadcast licenses have been renewed at the end of their respective periods, and we expect that all broadcast licenses will continue to be renewed in the future. Accordingly, we consider our broadcast licenses to be indefinite-lived intangible assets in accordance with FASB ASC Topic 350, *Intangibles - Goodwill and Other*. Broadcast licenses account for approximately 94% of our indefinite-lived intangible assets. Goodwill and magazine mastheads account for the remaining 6%. We do not amortize goodwill or other indefinite-lived intangible assets, but rather test for impairment at least annually or more frequently if events or circumstances indicate that an asset may be impaired.

We complete our annual impairment tests in the fourth quarter of each year. We believe that our estimate of the value of our broadcast licenses, mastheads, and goodwill is a critical accounting estimate as the value is significant in relation to our total assets, and our estimates incorporate variables and assumptions that are based on past experiences and judgment about future operating performance of our markets and business segments. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material. The fair value measurements for our indefinite-lived intangible assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. The unobservable inputs are defined in FASB ASC Topic 820 *Fair Value Measurements and Disclosures* as Level 3 inputs discussed in detail in Note 14 to our Condensed Consolidated Financial Statements. There were no indications of impairment present as of the period ending September 30, 2014.

NOTE 3. IMPAIRMENT OF LONG-LIVED ASSETS

We account for property, plant and equipment in accordance with FASB ASC Topic 360-10, *Property, Plant and Equipment*. We periodically review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying

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amount of the assets may not be fully recoverable. In accordance with authoritative guidance for impairment of long-lived assets, we must estimate the fair value of assets when events or circumstances indicate that they may be impaired. The fair value measurements for our long-lived assets use significant observable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material. There were no indications of impairment present as of the period ending September 30, 2014.

NOTE 4. ACQUISITIONS AND RECENT TRANSACTIONS

During the nine months ending September 30, 2014, we completed or entered into the following transactions:

Debt

On September 29, 2014, we repaid \$5.0 million in principal on our current senior secured credit facility, consisting of a term loan of \$300.0 million (Term Loan B) and paid interest as of that date. We recorded an \$18,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount.

On March 31, 2014, we repaid \$2.3 million in principal on our Term Loan B and paid interest due as of that date. We recorded an \$8,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount.

Equity

On September 2, 2014, we announced a quarterly distribution in the amount of \$0.0625 per share on Class A and Class B common stock. The quarterly distribution of \$1.6 million was paid on September 30, 2014 to all Class A and Class B common stockholders of record as of September 16, 2014.

On May 27, 2014, we announced a quarterly distribution in the amount of \$0.06 per share on Class A and Class B common stock. The quarterly distribution of \$1.5 million was paid on June 30, 2014 to all Class A and Class B common stockholders of record as of June 16, 2014.

On March 6, 2014, we announced a quarterly distribution in the amount of \$0.0575 per share on Class A and Class B common stock. The quarterly distribution of \$1.4 million was paid on March 31, 2014 to all Class A and Class B common stockholders of record as of March 17, 2014.

Acquisition of Eagle Publishing

On January 10, 2014, we acquired the entities of Eagle Publishing, including Regnery Publishing, HumanEvents.com, Redstate.com, Eagle Financial Publications and Eagle Wellness. We began operating these entities as of the closing date. The base purchase price was \$8.5 million, with \$3.5 million paid in cash upon closing, and deferred payments of \$2.5 million due January 2015 and \$2.5 million due January 2016. We paid an additional \$0.4 million of costs upon closing associated with liabilities incurred by the seller. On June 6, 2014, we paid \$1.5 million of the \$2.5 million deferred installment due January 2015. Based on the early payment, our deferred payment due January 2015 was reduced to \$0.9 million. The deferred payments due January 2015 and January 2016 are recorded at their present value of \$0.9 million and \$2.3 million, respectively, with the discount being amortized to non-cash interest expense over the payment term using the effective interest method.

We may pay up to an additional \$8.5 million of contingent earn-out consideration over the next three years based on the achievement of certain revenue benchmarks established for calendar years 2014, 2015 and 2016 for each of the Eagle entities. The purchase price includes the original estimated fair value of the contingent earn-out consideration recorded at the present value of \$2.0 million. The estimated fair value of the contingent earn-out consideration was determined using a probability-weighted discounted cash flow model. We determined the fair value of the contingent consideration obligations by calculating the probability-weighted earn-out payments based on the assessment of the likelihood that the benchmarks be achieved. The probability-weighted earn-out payments were then discounted using a discount rate based on an internal rate of return analysis using the probability-weighted cash flows. The fair value measurement includes revenue forecasts which are a Level 3 measurement as discussed in Note 14 to our Condensed Consolidated Financial Statements. The fair value of the contingent earn-out consideration will be reviewed quarterly over the remaining earn-out period based on actual revenue earned as compared to the estimated revenue used in our forecasts. Any changes in the estimated fair value of the contingent earn-out consideration, up to the total contractual amount, will be reflected in our results of operations in future periods as they are identified. Changes in the fair value of the contingent earn-out consideration may materially impact and cause volatility in our future operating results. Changes in our estimates for the contingent earn-out consideration are discussed in Note 5 to our Condensed Consolidated Financial Statements.

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We believe that strong author relationships, assembled creative talent agreements and the loyal readers of Eagle publications, as well as our ability to market and promote these products through our existing media platform, provides future economic benefits to us. We have recorded goodwill of \$2.3 million representing the excess value of these future economic benefits.

Other Acquisitions

On May 22, 2014, we completed the acquisition of radio station WOCN-AM, Miami, Florida and the related transmitter site for \$2.5 million in cash. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity as of the closing date. We will begin programming the station upon implementation of our format changes. We recorded goodwill of \$12,000 associated with the excess value of this entity attributable to the existing tower site, the related transmitter site and the audience reach obtained.

On May 6, 2014, we completed the acquisition of WRTH-FM (formerly WOLT-FM) in Greenville, South Carolina for \$1.1 million in cash. We began operating this station under an LMA as of February 28, 2014. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity as of the LMA date. We recorded goodwill of \$6,400 associated with the excess value of this entity attributable to the existing tower site and the audience reach obtained.

On April 15, 2014, we completed the acquisition of three FM translators for \$0.4 million in cash. The FM translators will serve our Orlando, Florida, Tampa, Florida and Omaha, Nebraska markets.

On February 7, 2014, we completed the acquisition of radio stations KDIS-FM, Little Rock, Arkansas and KRDY-AM, San Antonio, Texas for \$2.0 million in cash. We began operating these stations as of the closing date. The accompanying Condensed Consolidated Statement of Operations reflects the operating results of these entities as of the closing date. We recorded goodwill of \$18,000 associated with the excess value of these entities attributable to existing tower sites and the audience reach obtained.

Throughout the nine months ending September 30, 2014, we have acquired domain names associated with our Internet segment for an aggregate amount of approximately \$0.2 million in cash.

A summary of our business acquisitions and asset purchases for the nine months ended September 30, 2014, none of which were individually or in the aggregate material to our Condensed Consolidated financial position as of the respective date of acquisition, is as follows:

| Acquisition Date | Description | Total Cost <i>(Dollars in thousands)</i> |
|-------------------------|--|--|
| May 22, 2014 | WOCN-AM Miami, Florida (business acquisition) | \$ 2,450 |
| May 6, 2014 | WRTH-FM (formerly WOLT-FM), Greenville, South Carolina (business acquisition) | 1,125 |
| April 15, 2014 | FM Translators, Orlando, Florida, Tampa, Florida, Omaha, Nebraska (asset purchase) | 357 |
| February 7, 2014 | KDIS-FM, Little Rock Arkansas and KRDY-AM, San Antonio, Texas (business acquisition) | 1,984 |

| | | |
|------------------|---|------------------|
| | acquisition) | |
| January 10, 2014 | Eagle Publishing (business acquisition) | 10,628 |
| Various | Purchase of various Internet assets (asset purchases) | 408 |
| | | \$ 16,952 |

The operating results of these acquisitions are included in our consolidated results of operations from their respective closing date or LMA date. Under the acquisition method of accounting as specified in FASB ASC Topic 805 *Business Combinations*, the total acquisition consideration is allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the date of the transaction.

Estimates of the fair value include discounted estimated cash flows to be generated by the assets and their expected useful lives based on historical experience, market trends and any synergies believed to be achieved from the acquisition. Acquisitions may include contingent consideration, the fair value of which is estimated as of the acquisition date as the present value of the expected contingent payments as determined using weighted probabilities of the payment amounts. We may retain a third-party appraiser to estimate the fair value of the acquired net assets as of the acquisition date. As part of the valuation and appraisal process, the third-party appraiser prepares a report assigning estimated fair values to the various asset categories in our financial statements. These fair value estimates are subjective in nature and require careful consideration and judgment. Management reviews the third party reports for reasonableness of the assigned values. We believe that these valuations and analysis provide appropriate estimates of the fair value for net assets acquired.

Property, plant and equipment are recorded at the estimated fair value and depreciated on a straight-line basis over their estimated useful lives. Finite-lived intangible assets are recorded at their estimated fair value and amortized on a straight-line basis over their estimated useful lives. Goodwill, which represents the organizational systems and procedures in place to ensure the effective operation of the entity, may also be recorded and tested for impairment. Costs associated with acquisitions, such as consulting and legal fees are expensed as incurred in corporate operating expenses.

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The total acquisition consideration is equal to the sum of all cash payments, the fair value of any deferred payments and promissory notes, and the present value of any contingent earn-out consideration. We estimate the fair value of contingent earn-out consideration using a probability-weighted discounted cash flow model. The fair value measurement is based on significant inputs that are not observable in the market and thus represent a Level 3 measurement as defined in Note 14 -Fair Value Measurements. The following table summarizes the total acquisition consideration for the nine months ended September 30, 2014:

| Description | Total Consideration <i>(Dollars in thousands)</i> |
|--|---|
| Cash payments | \$ 10,678 |
| Escrow deposits paid in prior years | 1,345 |
| Deferred cash payments made related to prior year acquisition | (300) |
| Present value of deferred cash payments (due 2015) | 893 |
| Present value of deferred cash payments (due 2016) | 2,289 |
| Present value of estimated fair value of contingent earn-out consideration | 2,047 |
| Total purchase price consideration | \$ 16,952 |

The total acquisition consideration was allocated to the net assets acquired as follows:

| | Broadcast Assets Acquired | Internet Assets Acquired | Publishing Assets Acquired | Net Assets Acquired |
|--------------------------------------|--------------------------------------|-------------------------------------|---------------------------------------|--------------------------------|
| | <i>(Dollars in thousands)</i> | | | |
| Assets | | | | |
| Property and equipment | \$ 1,927 | \$ 1,099 | \$ 3,929 | \$ 6,955 |
| Developed websites | | 539 | 38 | 577 |
| Broadcast licenses | 3,953 | | | 3,953 |
| Goodwill | 36 | 2,128 | 189 | 2,353 |
| Customer lists and contracts | | 2,232 | 509 | 2,741 |
| Domain and brand names | | 1,921 | 843 | 2,764 |
| Subscriber base and lists | | 2,446 | | 2,446 |
| Author relationships | | | 1,682 | 1,682 |
| Non-compete agreements | | 79 | 66 | 145 |
| Liabilities | | | | |
| Deferred revenue & royalties assumed | | (3,779) | (2,885) | (6,664) |
| | \$ 5,916 | \$ 6,665 | \$ 4,371 | \$ 16,952 |

Pending Transactions

On May 29, 2014, we entered into an APA to acquire radio station KXXT-AM in Phoenix, Arizona for \$0.6 million. We began operating the station under an LMA as of June 6, 2014. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity as of the LMA date. The transaction closed on October 1, 2014.

Discontinued Operations

Based on operating results that did not meet our expectations, we ceased operating Samaritan Fundraising in December 2011. As of December 31, 2011, all employees of this entity were terminated. As a result of our decision to close operations, there have been no material cash flows associated with this entity and we have no ongoing or further involvement in the operations of this entity. The Condensed Consolidated Balance Sheets and Statements of Operations for all prior periods presented were reclassified to reflect the operating results and net assets of this entity as a discontinued operation.

The following table sets forth the components of the loss from discontinued operations:

| | Three Months Ended | |
|---|------------------------------------|---------|
| | September 30, September 30, | |
| | 2013 2013 | |
| | <i>(Dollars in thousands)</i> | |
| Net revenues | \$ | 11 |
| Operating expenses | (19) | (54) |
| Operating loss | \$ (19) | \$ (43) |
| Benefit from income taxes | (8) | (17) |
| Loss from discontinued operations, net of tax | \$ (11) | \$ (26) |

Table of Contents**NOTE 5. CONTINGENT EARN-OUT CONSIDERATION**

Our acquisitions of Twitchy.com and entities of Eagle Publishing included contingent consideration, the fair value of which was estimated on the acquisition date as the present value of the expected future contingent payments which we determined using a probability-weighted discounted cash flow model for probabilities of possible future payments.

The unobservable inputs used in determining the fair value of the contingent consideration include assumptions as to the ability of the acquired businesses to meet the targets and discount rates used in the calculation. Should the actual results of the acquired business increase or decrease as compared to our estimates and assumptions, the fair value of the contingent consideration obligations would increase or decrease, up to the contracted limit, as applicable. The fair value measurement includes revenue forecasts which are a Level 3 measurement as discussed in Note 14 to our Condensed Consolidated Financial Statements. Any changes in the estimated fair value of the contingent earn-out consideration, up to the contractual amounts, are reflected in our results of operations in the periods they are identified. Any changes in the estimated fair value of the contingent earn-out consideration may materially impact and cause volatility in our future operating results.

On December 10, 2013, we recorded an estimate of contingent earn-out consideration payable upon achievement of page view milestones over a two year period related to our acquisition of Twitchy.com. Using a probability-weighted discounted cash flow model, we estimated the fair value of the \$1.2 million total contingent earn-out consideration at the present value of \$0.6 million as of the closing date. During our quarterly reviews as of March 31, 2014, June 30, 2014 and September 30, 2014, we observed actual page views that were higher than those estimated at the time of our projections. We increased our future page view estimates and revised our probability-weighted discounted cash flow model for the updated projections. We recorded a \$58,000 and \$275,000 increase in the estimated fair value of the contingent earn-out consideration which is reflected in our operating results for the three and nine months ending September 30, 2014, respectively. We will continue to review our estimates quarterly over the remaining earn-out period of 1.25 years. We may pay up to an additional \$1.0 million of contingent earn-out consideration over the remaining earn-out period based on the achievement of certain page view milestones established in the purchase agreement. Any changes in the estimated fair value of the contingent earn-out consideration, up to the contracted amount, will be reflected in our results of operations in future periods as they are identified.

On January 10, 2014, we recorded an estimate of contingent earn-out consideration payable upon achievement of certain revenue benchmarks over a three year period related to the acquisition of the Eagle entities. Using a probability-weighted discounted cash flow model, we recorded the estimated fair value of the \$8.5 million total contingent earn-out consideration at the present value of \$2.0 million as of the closing date. There were no changes in our estimates as of the quarterly review performed as of March 31, 2014. During our quarterly reviews as of June 30, 2014 and September 30, 2014, we observed actual revenues that were higher than those estimated at the time of our original projections. We increased our revenue estimates and revised our probability-weighted discounted cash flow model for the updated projections. We recorded a \$0.5 million and \$0.6 million increase in the estimated fair value of the contingent earn-out consideration which is reflected in our operating results for the three and nine months ending September 30, 2014, respectively. We will continue to review our estimates quarterly over the remaining earn-out period of 2.50 years. Any changes in the estimated fair value of the contingent earn-out consideration, up to the contracted amount, will be reflected in our results of operations in future periods as they are identified.

The following table reflects the changes in the present value of our acquisition related contingent earn-out consideration for the three and nine months ended September 30, 2014:

**Three months ending
September 30, 2014**
(dollars in thousands)

| | Short-Term Accrued Expenses | Long-Term Other Liabilities | Total |
|---|--|--|-----------------|
| Beginning Balance as of July 1, 2014 | \$ 1,556 | \$ 1,599 | \$ 3,155 |
| Acquisitions | | | |
| Accretion of acquisition-related contingent consideration | 15 | 17 | 32 |
| Change in the estimated fair value of contingent earn-out consideration | 382 | 163 | 545 |
| Payments | (300) | | (300) |
| Ending Balance as of September 30, 2014 | \$ 1,653 | \$ 1,779 | \$ 3,432 |

**Nine months ending
September 30, 2014**
(dollars in thousands)

| | Short-Term Accrued Expenses | Long-Term Other Liabilities | Total |
|---|--|--|-----------------|
| Beginning Balance as of January 1, 2014 | \$ 329 | \$ 287 | \$ 616 |
| Acquisitions | 692 | 1,355 | 2,047 |
| Accretion of acquisition-related contingent consideration | 64 | 91 | 155 |
| Change in the estimated fair value of contingent earn-out consideration | 692 | 222 | 914 |
| Reclassification of payments due in next 12 month to short-term | 176 | (176) | |
| Payments | (300) | | (300) |
| Ending Balance as of September 30, 2014 | \$ 1,653 | \$ 1,779 | \$ 3,432 |

Table of Contents**NOTE 6. STOCK INCENTIVE PLAN**

The company has one stock incentive plan. The Amended and Restated 1999 Stock Incentive Plan (the Plan) allows the company to grant stock options and restricted stock to employees, directors, officers and advisors of the company. A maximum of 5,000,000 shares are authorized under the Plan. Options generally vest over a four year period and have a maximum term of five years from the vesting date. The Plan provides that vesting may be accelerated upon the occurrence of certain corporate transactions of the company. The Plan provides that the Board of Directors, or a committee appointed by the Board, has discretion, subject to certain limits, to modify the terms of outstanding options. We recognize non-cash stock-based compensation expense related to the estimated fair value of stock options granted in accordance with FASB ASC Topic 718 *Compensation - Stock Compensation*.

The following table reflects the components of stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2014:

| | Three Months Ended | | Nine Months Ended | |
|---|-------------------------------|-------------|-------------------------------|-------------|
| | September 30, 2013 | 2014 | September 30, 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | |
| Stock option compensation expense included in Corporate expenses | \$ 243 | \$ 223 | \$ 555 | \$ 843 |
| Restricted stock shares compensation expense included in Corporate expenses | | | 481 | |
| Stock option compensation expense included in Broadcast operating expenses | 43 | 64 | 260 | 253 |
| Stock option compensation expense included in Internet operating expenses | 62 | 40 | 195 | 134 |
| Stock option compensation expense included in Publishing operating expenses | 10 | 17 | 38 | 46 |
| Total stock-based compensation expense, pre-tax | \$ 358 | \$ 344 | \$ 1,529 | \$ 1,276 |
| Tax provision for stock-based compensation expense | (143) | (137) | (611) | (510) |
| Total stock-based compensation expense, net of tax | \$ 215 | \$ 207 | \$ 918 | \$ 766 |

Stock option and restricted stock grants

The Plan allows the company to grant stock options and shares of restricted stock to employees, directors, officers and advisors of the company. For grants of stock options, the option exercise price is set at the closing price of the company's common stock on the date of grant, and the related number of shares underlying the stock option is fixed at that point in time. The Plan also provides for grants of restricted stock. Eligible employees may receive stock options annually with the number of shares and type of instrument generally determined by the employee's salary grade and performance level. In addition, certain management and professional level employees typically receive a stock option grant upon commencement of employment. The Plan does not allow key employees and directors (restricted persons) to exercise options during pre-defined blackout periods. Employees may participate in plans established pursuant to Rule 10b5-1 under the Exchange Act that allow them to exercise options according to pre-established criteria.

We use the Black-Scholes valuation model to estimate the grant date fair value of stock options and restricted stock. The expected volatility reflects the consideration of the historical volatility of our stock as determined by the closing price over a six to ten year term that is generally commensurate with the expected term of the award. Expected dividends reflect the quarterly distributions authorized and declared on our Class A and Class B common stock as of the grant date. The expected term of the awards are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rates for periods within the expected term of the award are based on the U.S. Treasury yield curve in effect during the period the options were granted. We use historical data to estimate future forfeiture rates to apply against the gross amount of compensation expense determined using the valuation model.

The weighted-average assumptions used to estimate the fair value of the stock options and restricted stock awards using the Black-Scholes valuation model were as follows for the three and nine months ended September 30, 2013 and 2014:

| | Three Months Ended | | Nine Months Ended | |
|--------------------------|---------------------------|-------------|--------------------------|---------------|
| | September 30, | | September 30, | |
| | 2013 | 2014 | 2013 | 2014 |
| Expected volatility | n/a | n/a | 100.78% | 74.98% |
| Expected dividends | n/a | n/a | 2.05% | 2.70% |
| Expected term (in years) | n/a | n/a | 6.6 | 7.8 |
| Risk-free interest rate | n/a | n/a | 1.06% | 2.27% |

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Stock option information with respect to the company's stock-based equity plans during the nine months ended September 30, 2014 is as follows (*Dollars in thousands, except weighted average exercise price and weighted average grant date fair value*):

| Options | Shares | Weighted Average | | Weighted Average | | Aggregate Intrinsic Value |
|--|------------------|------------------|-----------------------|----------------------------|---------------------------|---------------------------|
| | | Exercise Price | Grant Date Fair Value | Remaining Contractual Term | Aggregate Intrinsic Value | |
| Outstanding at January 1, 2014 | 2,162,067 | \$ 5.09 | \$ 3.57 | 5.5 years | \$ 8,491 | |
| Granted | 25,000 | \$ 8.40 | \$ 4.73 | | \$ | |
| Exercised | (227,337) | \$ 4.82 | \$ 3.74 | | \$ 977 | |
| Forfeited or expired | (72,401) | \$ 13.30 | \$ 8.52 | | \$ 11 | |
| Outstanding at September 30, 2014 | 1,887,329 | \$ 4.85 | \$ 3.38 | 5.1 years | \$ 5,652 | |
| Exercisable at September 30, 2014 | 695,459 | \$ 5.18 | \$ 3.80 | 3.4 years | \$ 2,110 | |
| Expected to Vest | 1,131,684 | \$ 4.66 | \$ 3.13 | 6.1 years | \$ 3,363 | |

The aggregate intrinsic value represents the difference between the company's closing stock price on September 30, 2014 of \$7.61 and the option exercise price of the shares for stock options that were in the money, multiplied by the number of shares underlying such options. The total fair value of options vested during the nine months ended September 30, 2013 and 2014 was \$0.8 million and \$1.8 million, respectively.

As of September 30, 2014, there was \$1.3 million of total unrecognized compensation cost related to non-vested awards of stock options. This cost is expected to be recognized over a weighted-average period of 1.6 years.

NOTE 7. RECENT ACCOUNTING PRONOUNCEMENTS

Changes to accounting principles are established by the FASB in the form of accounting standards updates (ASUs) to the FASB's Accounting Standards Codification. We consider the applicability and impact of all ASUs. ASUs not listed below were assessed and determined to be not applicable to our financial position or results of operations.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*, which requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures. The new standard provides management with specific guidance on the assessments and related disclosures as well as provides a longer look-forward period as one year from the financial statement issuance date. The new standard is effective for the annual period ending after December 15, 2016, with early adoption permitted. The adoption of this ASU is not expected to have a material impact on our financial position, results of operations, cash flows, or presentation thereof.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new standard is effective as of the first interim period within annual reporting periods beginning on or after December 15, 2016, and will replace most existing revenue recognition guidance in U.S. GAAP. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures.

We have not yet selected a transition method nor have we determined the effect of this ASU on our financial position, results of operations, cash flows, or presentation thereof.

In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. ASU 2014-08 limits the requirement to report discontinued operations to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. The amendments also require expanded disclosures concerning discontinued operations and disclosures of certain financial results attributable to a disposal of a significant component of an entity that does not qualify for discontinued operations reporting. These amendments are effective prospectively for reporting periods beginning on or after December 15, 2014, with early adoption permitted. The adoption of this ASU is not expected to have a material impact on our financial position, results of operations, cash flows, or presentation thereof.

NOTE 8. EQUITY TRANSACTIONS

We account for stock-based compensation expense in accordance with FASB ASC Topic 718 *Compensation-Stock Compensation*. As a result, \$0.3 million and \$1.3 million of non-cash stock-based compensation expense has been recorded to additional paid-in capital for the three and nine months ended September 30, 2014, respectively, in comparison to \$0.4 million and \$1.5 million for the three and nine months ended September 30, 2013.

While we intend to pay regular quarterly distributions, the actual declaration of such future distributions and the establishment of the per share amount, record dates, and payment dates are subject to final determination by our Board of Directors and dependent

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upon future earnings, cash flows, financial requirements, and other factors. The current policy of the Board of Directors is to review each of these factors on a quarterly basis to determine the appropriate amount, if any, to allocate toward a cash distribution with the general principle of using approximately 20% of free cash flow. Free cash flow is a non-GAAP measure defined in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations included with this quarterly report.

The following table shows distributions that have been declared and paid since January 1, 2013:

| Announcement Date | Payment Date | Amount Per Share | Cash Distributed (in thousands) |
|--------------------|--------------------|------------------|------------------------------------|
| September 2, 2014 | September 30, 2014 | \$ 0.0625 | \$ 1,579 |
| May 27, 2014 | June 30, 2014 | \$ 0.0600 | 1,514 |
| March 6, 2014 | March 31, 2014 | \$ 0.0575 | 1,444 |
| November 20, 2013 | December 27, 2013 | \$ 0.0550 | 1,376 |
| September 12, 2013 | October 4, 2013 | \$ 0.0525 | 1,308 |
| May 30, 2013 | June 28, 2013 | \$ 0.0500 | 1,240 |
| March 18, 2013 | April 1, 2013 | \$ 0.0500 | 1,234 |

Based on the number of shares of Class A and Class B currently outstanding, and the currently approved distribution amount, we expect to pay total annual distributions of approximately \$6.1 million for the year ending December 31, 2014.

NOTE 9. NOTES PAYABLE AND LONG-TERM DEBT

Salem Communications Corporation has no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several, and any subsidiaries of the Salem Communications Corporation other than the subsidiary guarantors are minor.

Term Loan B and Revolving Credit Facility

On March 14, 2013, we entered into a senior secured credit facility, consisting of the Term Loan B of \$300.0 million and a revolving credit facility of \$25.0 million (Revolver). The Term Loan B was issued at a discount for total net proceeds of \$298.5 million. The discount is being amortized to non-cash interest expense over the life of the loan using the effective interest method. For each of the three and nine months ended September 30, 2013 and 2014, approximately \$47,000 and \$141,000 respectively, and \$48,000 and \$110,000, respectively, of the discount has been recognized as interest expense.

The Term Loan B has a term of seven years, maturing in March 2020. During this term, the principal amount may be increased by up to an additional \$60.0 million, subject to the terms and conditions of the credit agreement. We are required to make principal payments of \$750,000 per quarter which began on September 30, 2013 for the Term Loan B. Prepayments may be made against the outstanding balance of our Term Loan B. Each repayment of the outstanding Term Loan B is applied ratably to each of the next four principal installments thereof in the direct order of maturity and thereafter to the remaining principal balance in reverse order of maturity.

On September 29, 2014, we repaid \$5.0 million in principal on the Term Loan B and paid interest due as of that date. We recorded an \$18,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount on

the principal repaid. On March 31, 2014, we repaid \$2.3 million in principal on the Term Loan B and paid interest due as of that date. We recorded an \$8,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount on the principal repaid. As of September 30, 2014, accrued interest on the Term Loan B was \$36,000 and there are no quarterly principal payments due in the next twelve months.

Information regarding repayments of our Term Loan B is as follows:

| Date | Principal Paid | Unamortized Discount |
|--------------------|-------------------------------|----------------------|
| | <i>(Dollars in Thousands)</i> | |
| September 29, 2014 | \$ 5,000 | \$ 18 |
| March 31, 2014 | 2,250 | 8 |
| December 30, 2013 | 750 | 3 |
| September 30, 2013 | 4,000 | 16 |
| June 28, 2013 | 4,000 | 14 |

The Revolver has a term of five years, maturing in March 2018. We report outstanding balances on our Revolver as short-term based on use of the Revolver to fund ordinary and customary operating cash needs with repayments made frequently. We believe that the borrowing capacity under our Term Loan B and Revolver allows us to meet our ongoing operating requirements, fund capital expenditures and satisfy our debt service requirements for at least the next twelve months.

Borrowings under the Term Loan B may be made at LIBOR (subject to a floor of 1.00%) plus a spread of 3.50% or Wells Fargo's base rate plus a spread of 2.50%. Borrowings under the Revolver may be made at LIBOR or Wells Fargo's base rate plus a spread determined by reference to our leverage ratio, as set forth in the pricing grid below. If an event of default occurs under the credit agreement, the applicable interest rate may increase by 2.00% per annum. At September 30, 2014, the blended interest rate on amounts outstanding under the Term Loan B and Revolver was 5.04%.

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| Pricing Level | Consolidated Leverage Ratio | Revolver Pricing | |
|---------------|--|------------------|-------------|
| | | Base Rate Loans | LIBOR Loans |
| 1 | Less than 3.00 to 1.00 | 1.250% | 2.250% |
| 2 | Greater than or equal to 3.00 to 1.00 but less than 4.00 to 1.00 | 1.500% | 2.500% |
| 3 | Greater than or equal to 4.00 to 1.00 but less than 5.00 to 1.00 | 1.750% | 2.750% |
| 4 | Greater than or equal to 5.00 to 1.00 but less than 6.00 to 1.00 | 2.000% | 3.000% |
| 5 | Greater than or equal to 6.00 to 1.00 | 2.500% | 3.500% |

The obligations under the credit agreement and the related loan documents are secured by liens on substantially all of the assets of Salem and its subsidiaries, other than certain exceptions set forth in the Security Agreement, dated as of March 14, 2013, among Salem, the subsidiary guarantors party thereto, and Wells Fargo Bank, National Association, as Administrative Agent (the Security Agreement) and such other related loan documents.

With respect to financial covenants, the credit agreement includes a minimum interest coverage ratio, which started at 1.50 to 1.0 and steps up to 2.50 to 1.0 by 2016 and a maximum leverage ratio, which started at 6.75 to 1.0 and steps down to 5.75 to 1.0 by 2017. The credit agreement also includes other negative covenants that are customary for credit facilities of this type, including covenants that, subject to exceptions described in the credit agreement, restrict the ability of Salem and its subsidiary guarantors: (i) to incur additional indebtedness; (ii) to make investments; (iii) to make distributions, loans or transfers of assets; (iv) to enter into, create, incur, assume or suffer to exist any liens; (v) to sell assets; (vi) to enter into transactions with affiliates; or (vii) to merge or consolidate with, or dispose of all or substantially all assets to, a third party. As of September 30, 2014, our leverage ratio was 5.42 to 1 compared to our compliance covenant of 6.50 and our interest coverage ratio was 3.44 compared to our compliance ratio of 2.0. We were in compliance with our debt covenants under the credit facility at September 30, 2014.

Terminated Senior Secured Second Lien Notes

On December 1, 2009, we issued \$300.0 million principal amount of our 9 ⁵/₈% Notes Senior Secured Second Lien Notes due 2016 (Terminated 9 ⁵/₈% Notes) at a discount for \$298.1 million resulting in an effective yield of 9.75%. Interest was due and payable on June 15 and December 15 of each year, commencing June 15, 2010 until maturity. We were not required to make principal payments on the Terminated 9 ⁵/₈% Notes, which were due in full in December 2016. The Terminated 9 ⁵/₈% Notes were guaranteed by all of our existing domestic restricted subsidiaries. Upon issuance, we were required to pay \$28.9 million per year in interest on the then outstanding Terminated 9 ⁵/₈% Notes. As of December 31, 2012, accrued interest on the Terminated 9 ⁵/₈% Notes was \$0.9 million. The discount was being amortized to interest expense over the term of the Terminated 9 ⁵/₈% Notes based on the effective interest method. For the three and nine months ended September 30, 2013, approximately \$0 and \$37,000 of the discount, respectively, was recognized as interest expense.

On March 14, 2013, we tendered for \$212.6 million in aggregate principal amount of the Terminated 9 ⁵/₈% Notes for an aggregate purchase price of \$240.3 million, or at a price equal to 110.65% of the face value of the Terminated 9 ⁵/₈% Notes in the Tender Offer. We paid \$22.7 million for this repurchase resulting in a \$26.9 million pre-tax loss on the early retirement of long-term debt, which included approximately \$0.8 million of unamortized discount and \$2.9 million of bond issue costs associated with the Terminated 9 ⁵/₈% Notes. We issued a notice of redemption to redeem any of the Terminated 9 ⁵/₈% Notes that remained outstanding after the expiration date of the Tender Offer. On June 3, 2013, we redeemed the remaining \$0.9 million of the outstanding Terminated 9 ⁵/₈% Notes to satisfy and discharge Salem's obligations under the indenture for the Terminated 9 ⁵/₈% Notes. The carrying value of the Terminated 9 ⁵/₈% Notes was \$212.6 million at December 31, 2012. There are no outstanding Terminated 9 ⁵/₈% Notes as of the

effectiveness of the redemption.

Information regarding repurchases and redemptions of the Terminated 9 ⁵/₈% Notes is as follows:

| Date | Principal Redeemed/Repurchased | Premium Paid | Unamortized Discount | Bond Issue Costs |
|-------------------|---|-------------------------|---------------------------------|-----------------------------|
| | <i>(Dollars in thousands)</i> | | | |
| June 3, 2013 | \$ 903 | \$ 27 | \$ 3 | \$ |
| March 14, 2013 | 212,597 | 22,650 | 837 | 2,867 |
| December 12, 2012 | 4,000 | 120 | 17 | 57 |
| June 1, 2012 | 17,500 | 525 | 80 | 287 |
| December 12, 2011 | 12,500 | 375 | 62 | 337 |
| September 6, 2011 | 5,000 | 144 | 26 | 135 |
| June 1, 2011 | 17,500 | 525 | 93 | 472 |
| December 1, 2010 | 12,500 | 375 | 70 | 334 |
| June 1, 2010 | 17,500 | 525 | 105 | 417 |

Table of Contents**Terminated Senior Credit Facility**

On December 1, 2009, we entered into a Revolver (Terminated Revolver). We amended the Terminated Revolver on November 1, 2010 to increase the borrowing capacity from \$30 million to \$40 million. The amendment allowed us to use borrowings under the Revolver, subject to the Available Amount as defined by the terms of the credit agreement, to redeem applicable portions of the Terminated 9⁵/₈% Notes. The calculation of the Available Amount also pertained to the payment of dividends when the leverage ratio was above 5.0 to 1.

On November 15, 2011, we completed the Second Amendment of the Terminated Revolver to, among other things, (1) extend the maturity date from December 1, 2012 to December 1, 2014, (2) change the interest rate applicable to LIBOR or the Wells Fargo base rate plus a spread to be determined based on our leverage ratio, (3) allow us to borrow and repay unsecured indebtedness provided certain conditions are met and (4) include step-downs related to our leverage ratio covenant. We incurred \$0.5 million in fees to complete this amendment, which were being amortized over the remaining term of the agreement. The applicable interest rate relating to the amended credit agreement was LIBOR plus a spread of 3.00% per annum or the Base Rate plus a spread of 1.25% per annum, which was adjustable based on our leverage ratio. If an event of default occurred, the interest rate could be increased by 2.00% per annum. Details of the change in our rate based on our leverage ratio were as follows:

| Consolidated Leverage Ratio | Eurodollar Applicable Fee | | |
|--|---------------------------|------------|-------|
| | Base Rate | Rate Loans | Rate |
| Less than 3.25 to 1.00 | 0.75% | 2.25% | 0.40% |
| Greater than or equal to 3.25 to 1.00 but less than 4.50 to 1.00 | 0.75% | 2.50% | 0.50% |
| Greater than or equal to 4.50 to 1.00 but less than 6.00 to 1.00 | 1.25% | 3.00% | 0.60% |
| Greater than or equal to 6.00 to 1.00 | 2.25% | 3.50% | 0.75% |

The Terminated Revolver included a \$5 million subfacility for standby letters of credit and a subfacility for swingline loans of up to \$5 million, subject to the terms and conditions of the credit agreement relating to the Terminated Revolver. In addition to interest charges outlined above, we paid a commitment fee on the unused balance based on the Applicable Fee Rate in the above table.

The Terminated Revolver was terminated on March 14, 2013 upon entry into our current senior secured credit facility. This termination resulted in a \$0.9 million pre-tax loss on the early retirement of long-term debt related to unamortized credit facility fees. There was no outstanding balance on the Terminated Revolver as of the termination date.

Terminated Subordinated Credit Facility with First California Bank

On May 21, 2012, we entered into a Business Loan Agreement, Promissory Note and related loan documents with First California Bank (the FCB Loan). The FCB Loan was an unsecured, \$10.0 million fixed-term loan with a maturity date of June 15, 2014. The interest rate for the FCB Loan (Interest Rate) was variable and was equal to the greater of: (a) 4.250% or (b) the Wall Street Journal Prime Rate as published in The Wall Street Journal and reported by FCB plus 1%.

We were required to repay the FCB Loan as follows: (a) twenty-three (23) consecutive monthly interest payments based upon the then-current principal balance outstanding at the then-current Interest Rate commencing on

September 15, 2012; (b) seven (7) quarterly consecutive principal payments of \$1.25 million each commencing on September 15, 2012; and (c) one (1) final principal and interest payment on June 15, 2014 of all outstanding and unpaid interest and principal as of such maturity date. The FCB Loan could be prepaid at any time subject to a minimum interest charge of fifty dollars (\$50). If an event of default occurred on the FCB Loan, the Interest Rate could have been increased by 5.00% per annum.

The FCB loan was terminated on March 14, 2013 upon entry into our current senior secured credit facility. This termination resulted in a \$33,000 pre-tax loss on the early retirement of long-term debt for unamortized credit facility fees. There was no outstanding balance on the FCB Loan as of the termination date.

Terminated Subordinated Debt due to Related Parties

On November 17, 2011, we entered into subordinated lines of credit Terminated Subordinated Debt due Related Parties with Edward G. Atsinger III, Chief Executive Officer and director of Salem, and Stuart W. Epperson, Chairman of Salem's Board of Directors. Pursuant to the related agreements, Mr. Epperson committed to provide an unsecured revolving line of credit to Salem in a principal amount of up to \$3 million, and Mr. Atsinger committed to provide an unsecured revolving line of credit in a principal amount of up to \$6 million. On May 21, 2012, we also entered into a subordinated line of credit with Roland S. Hinz, a Salem board member. Mr. Hinz committed to provide an unsecured revolving line of credit in a principal amount of up to \$6 million. On September 12, 2012, we amended and restated the original subordinated line of credit with Mr. Hinz to increase the unsecured revolving line of credit by \$6 million for a total line of credit of up to \$12 million.

The proceeds of the Terminated Subordinated Debt due to Related Parties could be used to repurchase a portion of the Terminated 9 5/8% Notes. Outstanding amounts under each subordinated line of credit bore interest at a rate equal to the lesser of (1) 5% per

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annum and (2) the maximum rate permitted for subordinated debt under the Terminated Revolver referred to above plus 2% per annum. Interest was payable at the time of any repayment of principal. In addition, outstanding amounts under each subordinated line of credit were required to be repaid within three (3) months from the time that such amounts were borrowed, with the exception of the subordinated line of credit with Mr. Hinz, which was to be repaid within six (6) months from the time that such amounts were borrowed. The Terminated Subordinated Debt due to Related Parties did not contain any covenants. On March 14, 2013, we repaid these lines of credit upon entry into our current senior secured credit facility. On April 3, 2013, we provided written notice to Messrs. Atsinger, Epperson and Hinz electing to terminate the Terminated Subordinated Debt due to Related Parties and related agreements effective as of May 3, 2013. There were no outstanding balances on the Terminated Subordinated Debt due to Related Parties as of the termination date.

Summary of long-term debt obligations

Long-term debt consisted of the following:

| | As of December 31, 2013 and September 30, 2014 | |
|--------------------------------|--|------------|
| | <i>(Dollars in thousands)</i> | |
| Term Loan B | \$ 289,939 | \$ 282,856 |
| Revolver | | 2,759 |
| Capital leases and other loans | 854 | 762 |
| | 290,793 | 286,377 |
| Less current portion | (3,121) | (2,871) |
| | \$ 287,672 | \$ 283,506 |

In addition to the outstanding amounts listed above, we also have interest payments related to our long-term debt as follows as of September 30, 2014:

Outstanding borrowings of \$284.0 million under the Term Loan B with interest payments due at LIBOR (subject to a floor of 1.00%) plus 3.50% or prime rate plus 2.50%; and

Outstanding borrowings of \$2.8 million under the Revolver, with interest payments due at LIBOR plus 3.00% or at prime rate plus 2.00%.

Other Debt

We have several capital leases related to office equipment. The obligation recorded at December 31, 2013 and September 30, 2014 represents the present value of future commitments under the capital lease agreements.

Maturities of Long-Term Debt

Principal repayment requirements under all long-term debt agreements outstanding at September 30, 2014 for each of the next five years and thereafter are as follows:

| For the Twelve Months Ended September 30, | Amount |
|--|-------------------------------|
| | <i>(Dollars in thousands)</i> |
| 2015 | \$ 2,871 |
| 2016 | 3,095 |
| 2017 | 3,098 |
| 2018 | 3,095 |
| 2019 | 3,091 |
| Thereafter | 271,127 |
| | \$ 286,377 |

NOTE 10. DEFERRED FINANCING COSTS

Deferred financing costs consist of bank loan fees incurred upon entering our Term Loan B and Revolver as of September 30, 2013. The costs are being amortized over the seven year term of the Term Loan B and the five year term of the Revolver as an adjustment to interest expense. Deferred financing costs were \$4.1 million and \$3.6 million at December 31, 2013 and September 30, 2014, respectively.

Table of Contents**NOTE 11. AMORTIZABLE INTANGIBLE ASSETS**

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

| | As of September 30, 2014 | | |
|-------------------------------------|---------------------------------|-----------------------------|------------------|
| | Cost | Accumulated Amortization | Net |
| | <i>(Dollars in thousands)</i> | | |
| Customer lists and contracts | \$ 19,910 | \$ (15,885) | \$ 4,025 |
| Domain and brand names | 15,464 | (9,321) | 6,143 |
| Favorable and assigned leases | 2,358 | (1,772) | 586 |
| Subscriber base and lists | 4,302 | (2,467) | 1,835 |
| Author relationships | 2,245 | (1,175) | 1,070 |
| Non-compete agreements | 888 | (644) | 244 |
| Other amortizable intangible assets | 1,336 | (1,336) | |
| | \$ 46,503 | \$ (32,600) | \$ 13,903 |

| | As of December 31, 2013 | | |
|-------------------------------------|--------------------------------|-----------------------------|-----------------|
| | Cost | Accumulated Amortization | Net |
| | <i>(Dollars in thousands)</i> | | |
| Customer lists and contracts | \$ 17,170 | \$ (13,830) | \$ 3,340 |
| Domain and brand names | 12,700 | (8,124) | 4,576 |
| Favorable and assigned leases | 2,358 | (1,701) | 657 |
| Subscriber base and lists | 1,856 | (1,856) | |
| Author relationships | 563 | (563) | |
| Non-compete agreements | 743 | (550) | 193 |
| Other amortizable intangible assets | 1,336 | (1,309) | 27 |
| | \$ 36,726 | \$ (27,933) | \$ 8,793 |

Based on the amortizable intangible assets as of September 30, 2014, we estimate amortization expense for the next five years to be as follows:

| Year Ending December 31, | Amortization Expense |
|---------------------------------|-------------------------------|
| | <i>(Dollars in thousands)</i> |
| 2014 (Oct Dec) | \$ 1,528 |
| 2015 | 4,851 |
| 2016 | 2,934 |
| 2017 | 1,532 |
| 2018 | 1,318 |
| Thereafter | 1,740 |

| | | |
|-------|----|--------|
| Total | \$ | 13,903 |
|-------|----|--------|

NOTE 12. BASIC AND DILUTED NET EARNINGS PER SHARE

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

Options to purchase 2,296,020 and 1,887,329 shares of Class A common stock were outstanding at September 30, 2013 and September 30, 2014, respectively. Diluted weighted average shares outstanding exclude outstanding stock options whose exercise price is in excess of the average price of the company's stock price. These options are excluded from the respective computations of diluted net income or loss per share because their effect would be anti-dilutive. As of September 30, 2013 and September 30, 2014 there were 794,553 and 729,560 dilutive shares, respectively.

NOTE 13. DERIVATIVE INSTRUMENTS

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

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Under FASB ASC Topic 815 *Derivatives and Hedging* the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income (outside earnings) and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings. The remaining gain or loss on the derivative instrument, if any, shall be recognized currently in earnings.

On March 27, 2013, we entered into an interest rate swap agreement with Wells Fargo Bank, N.A. that began on March 28, 2014 with a notional principal amount of \$150.0 million. The agreement was entered to offset risks associated with the variable interest rate on our Term Loan B. Payments on the swap are due on a quarterly basis with a LIBOR floor of 0.625%. The swap expires on March 28, 2019 at a fixed rate of 1.645%. The interest rate swap agreement was not designated as a cash flow hedge, and as a result, all changes in the fair value are recognized in the current period statement of operations rather than through other comprehensive income. We recorded an asset of \$1.8 million as of September 30, 2014, representing the fair value of the interest rate swap agreement. The swap was valued based on observable inputs for similar assets and liabilities and other observable inputs for interest rates and yield curves, which are classified within Level 2 inputs in the fair value hierarchy described in Note 14.

NOTE 14. FAIR VALUE MEASUREMENTS

FASB ASC Topic 820 *Fair Value Measurements and Disclosures* established a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring fair value. This framework defines three levels of inputs to the fair value measurement process and requires that each fair value measurement be assigned to a level corresponding to the lowest level input that is significant to the fair value measurement in its entirety. The three broad levels of inputs defined by the FASB ASC Topic 820 hierarchy are as follows:

Level 1 Inputs quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date;

Level 2 Inputs inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability; and

Level 3 Inputs unobservable inputs for the asset or liability. These unobservable inputs reflect the entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability, and are developed based on the best information available in the circumstances (which might include the reporting entity's own data).

As of September 30, 2014, the carrying value of cash and cash equivalents, trade accounts receivables, accounts payable, accrued expenses and accrued interest approximates fair value due to the short-term nature of such instruments. The carrying value of other long-term liabilities approximates fair value as the related interest rates approximate rates currently available to the company. The following table summarizes the fair value of our financial assets and liabilities measured at fair value:

September 30, 2014

| | Total Fair Value and Carrying Value on Balance Sheet | Fair Value Measurement Category | | |
|--|--|------------------------------------|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| <i>(Dollars in thousands)</i> | | | | |
| Assets: | | | | |
| Cash and cash equivalents | \$ 311 | \$ 311 | \$ | \$ |
| Trade accounts receivable, net | 40,168 | 40,168 | | |
| Fair value of interest rate swap | 1,754 | | 1,754 | |
| Liabilities: | | | | |
| Accounts payable | 5,252 | 5,252 | | |
| Accrued expenses including estimated fair value of contingent earn-out consideration | 13,324 | 11,671 | | 1,653 |
| Accrued interest | 45 | 45 | | |
| Long term liabilities including estimated fair value of contingent earn-out consideration | 4,151 | 2,372 | | 1,779 |
| Long-term debt | 286,377 | 286,377 | | |

NOTE 15. INCOME TAXES

We account for income taxes in accordance with FASB ASC Topic 740 *Income Taxes*. We recorded a decrease in our unrecognized tax benefits of \$0.03 million and \$0.04 million, respectively, as of September 30, 2013 and September 30, 2014. At December 31, 2013, we had \$0.9 million in liabilities for unrecognized tax benefits. Included in this liability amount were \$0.02 million accrued for the related interest, net of federal income tax benefits, and \$0.02 million for the related penalty recorded in income tax expense on our Condensed Consolidated Statements of Operations. We expect to reduce the reserve balance by \$0.4 million over the next twelve months due to statute expirations.

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Valuation Allowance (Deferred Taxes)

For financial reporting purposes, we recorded a valuation allowance of \$2.9 million as of September 30, 2014 to offset a portion of the deferred tax assets related to the state net operating loss carryforwards. We regularly review 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 our estimate of the benefit the company will receive from such carryforwards.

NOTE 16. COMMITMENTS AND CONTINGENCIES

We enter into various agreements in the normal course of business that contain minimum guarantees. The typical minimum guarantee is tied to future revenue amounts that exceed the contractual level. Accordingly, the fair value of these arrangements is zero.

The company and its subsidiaries, incident to its business activities, are parties to a number of legal proceedings, lawsuits, arbitration and other claims. Such matters are subject to many uncertainties and outcomes that are not predictable with assurance. The company maintains insurance that may provide coverage for such matters. Consequently, the company is unable to ascertain the ultimate aggregate amount of monetary liability or the financial impact with respect to these matters. We do not believe, at this time, that these legal proceedings, individually and in the aggregate, give rise to a reasonable likelihood of material loss to the company's consolidated financial position, results of operations or cash flows.

NOTE 17. SEGMENT DATA

FASB ASC Topic 280 *Segment Reporting* requires companies to provide certain information about their operating segments. We operate in three segments—radio broadcasting, Internet and publishing—of which our radio broadcasting and Internet segment are reportable segments. Our radio broadcasting segment operates radio stations throughout the United States, as well as various radio networks and our sales groups. Our Internet segment operates all of our websites, digital publications and consumer product sales. Our publishing segment operates Regnery Publishing, our print magazines and Xulon Press, a print-on-demand book publisher.

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

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| | Radio Broadcast | Internet and e-commerce | Publishing | Corporate | Consolidated |
|--|-------------------------------|------------------------------------|-------------------|------------------|---------------------|
| | <i>(Dollars in thousands)</i> | | | | |
| Three Months Ended September 30, 2014 | | | | | |
| Net revenue | \$ 46,962 | \$ 14,511 | \$ 8,130 | \$ | \$ 69,603 |
| Operating expenses | 32,596 | 10,931 | 6,766 | 5,254 | 55,547 |
| Net operating income (loss) before depreciation, amortization, change in the estimated fair value of contingent earn-out consideration and gain on disposal of assets | \$ 14,366 | \$ 3,580 | \$ 1,364 | \$ (5,254) | \$ 14,056 |
| Depreciation | 1,971 | 764 | 130 | 276 | 3,141 |
| Amortization | 23 | 1,202 | 304 | 1 | 1,530 |
| Change in the estimated fair value of contingent earn-out consideration | | 58 | 487 | | 545 |
| Gain on disposal of assets | (7) | | | | (7) |
| Net operating income (loss) from continuing operations | \$ 12,379 | \$ 1,556 | \$ 443 | \$ (5,531) | \$ 8,847 |
| Three Months Ended September 30, 2013 | | | | | |
| Net revenue | \$ 46,015 | \$ 9,390 | \$ 3,071 | \$ | \$ 58,476 |
| Operating expenses | 30,847 | 6,644 | 3,301 | 4,951 | 45,743 |
| Net operating income (loss) before depreciation, amortization, and (gain) loss on disposal of assets | \$ 15,168 | \$ 2,746 | \$ (230) | \$ (4,951) | \$ 12,733 |
| Depreciation | 1,986 | 702 | 115 | 286 | 3,089 |
| Amortization | 39 | 655 | 1 | | 695 |
| (Gain) loss on disposal of assets | (35) | | | 10 | (25) |
| Net operating income (loss) from continuing operations | \$ 13,178 | \$ 1,389 | \$ (346) | \$ (5,247) | \$ 8,974 |
| Nine Months Ended September 30, 2014 | | | | | |
| Net revenue | \$ 140,393 | \$ 41,811 | \$ 18,369 | \$ | \$ 200,573 |
| Operating expenses | 97,695 | 30,811 | 17,624 | 17,542 | 163,672 |
| | \$ 42,698 | \$ 11,000 | \$ 745 | \$ (17,542) | \$ 36,901 |

Net operating income (loss) before depreciation, amortization, change in the estimated fair value of contingent earn-out consideration and loss on disposal of assets

| | | | | | |
|---|-----------|----------|------------|-------------|-----------|
| Depreciation | 5,954 | 2,278 | 364 | 841 | 9,437 |
| Amortization | 75 | 3,682 | 909 | 1 | 4,667 |
| Change in the estimated fair value of contingent earn-out consideration | | 275 | 639 | | 914 |
| Loss on disposal of assets | 214 | | | | 214 |
| Net operating income (loss) from continuing operations | \$ 36,455 | \$ 4,765 | \$ (1,167) | \$ (18,384) | \$ 21,669 |

Nine Months Ended September 30, 2013

| | | | | | |
|--|------------|-----------|------------|-------------|------------|
| Net revenue | \$ 136,287 | \$ 29,012 | \$ 8,941 | \$ | \$ 174,240 |
| Operating expenses | 91,258 | 20,372 | 9,776 | 15,839 | 137,245 |
| Net operating income (loss) before depreciation, amortization, impairments and (gain) loss on disposal of assets | \$ 45,029 | \$ 8,640 | \$ (835) | \$ (15,839) | \$ 36,995 |
| Depreciation | 5,923 | 2,189 | 349 | 852 | 9,313 |
| Amortization | 117 | 1,954 | 5 | | 2,076 |
| Impairment of indefinite-lived long-term assets other than goodwill | | | 345 | | 345 |
| Impairment of goodwill | | | 438 | | 438 |
| (Gain) loss on disposal of assets | (30) | | | 10 | (20) |
| Net operating income (loss) from continuing operations | \$ 39,019 | \$ 4,497 | \$ (1,972) | \$ (16,701) | \$ 24,843 |

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| | Radio Broadcast | Internet and e-commerce | Publishing | Corporate | Consolidated |
|--|-------------------------------|------------------------------------|-------------------|------------------|---------------------|
| | <i>(Dollars in thousands)</i> | | | | |
| As of September 30, 2014 | | | | | |
| Inventories, net | \$ | \$ 292 | \$ 334 | \$ | \$ 626 |
| Property, plant and equipment, net | 82,889 | 7,091 | 2,017 | 8,299 | 100,296 |
| Broadcast licenses | 385,554 | | | | 385,554 |
| Goodwill | 3,954 | 19,677 | 1,088 | 8 | 24,727 |
| Other indefinite-lived intangible assets | | | 868 | | 868 |
| Amortizable intangible assets, net | 586 | 11,086 | 2,229 | 2 | 13,903 |
| As of December 31, 2013 | | | | | |
| Property, plant and equipment, net | \$ 82,457 | \$ 6,402 | \$ 1,596 | \$ 8,473 | \$ 98,928 |
| Broadcast licenses | 381,836 | | | | 381,836 |
| Goodwill | 3,917 | 17,550 | 899 | 8 | 22,374 |
| Other indefinite-lived intangible assets | | | 868 | | 868 |
| Amortizable intangible assets, net | 661 | 8,119 | 11 | 2 | 8,793 |

NOTE 18. SUBSEQUENT EVENTS

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

On October 1, 2014, we completed the acquisition of radio station KXXT-AM in Phoenix, Arizona for \$0.6 million in cash. We began operating the station under an LMA as of June 6, 2014. The accompanying Condensed Consolidated Statements of Operations reflect the operating results of this entity as of the LMA date.

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

GENERAL

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related notes included elsewhere in this report. Our Condensed Consolidated Financial Statements are not directly comparable from period to period due to acquisitions and dispositions of selected assets of radio stations and acquisitions of various Internet and publishing businesses. See Note 4 of our Condensed Consolidated Financial Statements for additional information.

Salem is a diversified multi-media company with integrated business operations covering radio broadcasting, content programming, publishing, and the Internet. Our programming is intended for audiences interested in Christian and family-themed content and conservative news talk.

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

Broadcast Segment

Our foundational business is the ownership and operation of radio stations in large metropolitan markets. Our broadcasting business also includes Salem Radio Network® (SRN), SRN News Network (SNN), Salem Music Network (SMN), Solid Gospel Network (SGN), Salem Media Representatives (SMR) and Vista Media Representatives (VMR). SRN, SNN, SMN and SGN are networks that produce and distribute programming, such as talk, news and music segments to radio stations throughout the United States, including Salem owned and operated stations. SMR and VMR sell commercial airtime to national advertisers on radio stations and networks that we own, as well as on independent radio station affiliates.

Our broadcast revenues are generated from the sale of local and national advertising time, the sale of local and national programming time, the sale of network programs, and locally sponsored events. Broadcast revenues are impacted by the program rates our radio stations charge, the level of broadcast airtime sold and by the advertising rates our radio stations and networks charge. The rates for block programming time are based upon our stations' ability to attract audiences that will support the program producers through contributions and purchases of their products. Advertising rates are based upon the demand for advertising time, which in turn is based on our stations and networks' ability to produce results for their advertisers. We do not subscribe to traditional audience measuring services for most of our radio stations. Instead, we have marketed ourselves to advertisers based upon the responsiveness of our audiences. In selected markets, we subscribe to Nielsen Audio, which develops quarterly reports to measure a radio station's audience share in the demographic groups targeted by advertisers. Each of our radio stations and our networks has a pre-determined level of time that they make available for block programming and/or advertising, which may vary at different times of the day.

Nielsen Audio has developed technology to collect data for its ratings service. The Portable People Meter™ (PPM) is a small device that does not require active manipulation by the end user and is capable of automatically measuring radio, television, Internet, satellite radio and satellite television signals that are encoded for the service by the broadcaster. The PPM offers a number of advantages over the traditional diary ratings collection system including

ease of use, more reliable ratings data and shorter time periods between when advertising runs and when audience listening or viewing habits can be reported. This service is already in a number of our markets and is scheduled to be introduced in more markets in the future. In markets where we subscribe to Nielsen Audio under the PPM, our ratings have been less consistent. PPM data can fluctuate when changes are made to the panel (a group of individuals holding PPM devices). As a result, all radio broadcast stations, including ours, are susceptible to some inconsistencies in ratings that may or may not accurately reflect the actual number of listeners at any given time.

As is typical in the radio broadcasting industry, our second and fourth quarter advertising revenue generally exceeds our first and third quarter advertising revenue. This seasonal fluctuation in advertising revenue corresponds with quarterly fluctuations in the retail advertising industry. Additionally, we experience increased demand for advertising time during election years for political advertisements. Quarterly revenue from the sale of block programming time does not tend to vary significantly because program rates are generally set annually and are recognized on a per program basis. We currently program 41 of our stations with our Christian Teaching and Talk format, which is predominantly long-form talk programming with Christian and family themes. We also program 27 News Talk stations, 12 Contemporary Christian Music stations, 10 Business format stations, and eight Spanish-language Christian Teaching and Talk stations. Our business format stations operate similar to our Christian Teaching and Talk format in that they also feature long-form block programming, but with financial experts, business talk, and nationally recognized Bloomberg programming. Our remaining stations are programmed in various other formats including ethnic, country and oldies.

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

In the broadcasting industry, radio stations often utilize trade or barter agreements to exchange advertising time for goods or services in lieu of cash. In order to preserve the sale of our advertising time for cash, we generally enter into trade agreements only if the goods or services bartered to us will be used in our business. We have minimized our use of trade agreements and have generally sold most of our advertising time for cash. In 2013, we sold 97 % of our broadcast revenue for cash. Our general policy is not to preempt advertising paid for in cash with advertising paid for in trade.

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

Internet & e-commerce Segment

Internet and e-commerce has been a significant area of growth for Salem and continues to be a prime focus for our future development. Salem Web Network (SWN) and our other Internet businesses provide Christian and conservative-themed content, audio and video streaming, and other resources digitally through the web. SWN's Internet portals include Christian content websites: OnePlace.com, Christianity.com, Crosswalk.com®, GodVine.com, Jesus.org and BibleStudyTools.com. Our conservative opinion websites include Townhall.com and HotAir.com. Townhall.com also operates Twitchy.com and as of January 10, 2014, HumanEvents.com and RedState.com. All of our digital content is accessible through our radio station websites that also promote local content of interest to our audiences throughout the United States.

Our Internet and e-commerce segment also operates church product websites including WorshipHouseMedia.com, SermonSpice.com and ChurchStaffing.com. We offer books, DVD's and editorial content developed by our on-air personalities through the Salem Consumer Products website. As of January 10, 2014, our Internet and e-commerce segment includes e-book sales through Regnery Publishing; distribution of digitally delivered newsletters featuring market analysis and investment advice through Eagle Financial Publications; and complimentary health advice and nutritional products through Eagle Wellness.

Our Internet and e-commerce revenues are generated from sales of digital advertising, streaming services, e-books, digital e-mail and newsletter subscriptions, product sales and royalties, consumer products including e-book sales, DVD's, and editorial materials created by our on-air hosts, wellness products, and video and graphic downloads. The revenues of these businesses are reported as Internet and e-commerce revenue on our Condensed Consolidated Statements of Operations. Similarly to our broadcasting segment, our second and fourth quarter advertising revenue generally exceeds our first and third quarter advertising revenue. This seasonal fluctuation in advertising revenue corresponds with quarterly fluctuations in the retail advertising industry. We also experience fluctuations in quarter over quarter comparisons based on the date in which the Easter holiday is observed as this holiday generates a higher volume of video downloads associated with church products. Additionally, we experience increased demand for advertising time and placement during election years for political advertisements.

The primary operating expenses incurred in the ownership and operation of our Internet businesses include: (i) employee salaries, commissions and related employee benefits and taxes, (ii) facility expenses such as rent and utilities, (iii) marketing and promotional expenses, (iv) royalties, (v) streaming costs and (vi) costs of goods sold associated with Eagle Wellness products.

Publishing Segment

Our acquisition of Regnery Publishing on January 10, 2014, represents a major shift in our publishing segment. Regnery Publishing is a publisher of conservative books that was founded in 1947. Regnery has published dozens of bestselling books by leading conservative authors and personalities, including Ann Coulter, Newt Gingrich, Michelle Malkin, David Limbaugh, Ed Klein, Laura Ingraham, Mark Steyn and Dinesh D Souza.

Our publishing segment also includes Salem Publishing , a producer and distributor of Christian and conservative opinion print magazines and Xulon Press , a print-on-demand self-publishing service for Christian authors.

Publishing revenues include the sale of books, advertising in and subscriptions to our print magazines, and revenues from fees paid by authors in association with the publishing, editing and marketing of their books. Revenues of these entities are reported as publishing on our Condensed Consolidated Statements of Operations. Book publishing revenues and cash flows are typically higher

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in the second and fourth quarter of each year when bigger titles are released. Print magazine revenues are higher in the second and fourth quarter as we publish more titles in those quarters. Similarly to our broadcasting segment, our second and fourth quarter advertising revenue generally exceeds our first and third quarter advertising revenue. This seasonal fluctuation in advertising revenue corresponds with quarterly fluctuations in the retail advertising industry. Additionally, we experience increased demand for advertising placement during election years for political advertisements.

The primary operating expenses incurred by Salem Publishing include: (i) employee salaries, commissions and related employee benefits and taxes, (ii) facility expenses such as rent and utilities, (iii) marketing and promotional expenses (iv) printing and production costs, including paper costs, (v) cost of goods sold and (vi) inventory reserves associated with Regnery Publishing.

OVERVIEW

Our radio-broadcasting segment derives revenue primarily from the sale of block programming time and advertising, both at a national and local level.

Our principal sources of broadcast revenue include:

the sale of block program time, both to national and local program producers;

the sale of advertising time on our radio stations, both to national and local advertisers;

the sale of advertising time on our national radio network; and

revenue derived from radio station sponsored events.

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

audience share;

how well our stations perform for our clients;

the size of the market;

the general economic conditions in each market; and

supply and demand on both a local and national level.

Our principal sources of Internet and e-commerce revenue include:

the sale of digital advertising;

the support and promotion to stream third-party content on our websites;

e-books;

digital e-mail and newsletter subscriptions;

product sales and royalties for on-air host materials including editorial publications;

nutritional product sales; and

video and graphic downloads.

Our principal sources of publishing revenue include:

the sale of books;

subscription fees for our magazines;

the sale of print magazine advertising; and

fees from authors for book publishing.

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 September 30, 2014 compared to the three months ended September 30, 2013

The following factors affected our results of operations and cash flows for the three months ended September 30, 2014 as compared to the same period of the prior year:

Financing

On September 29, 2014, we repaid \$5.0 million in principal on our current senior secured credit facility, consisting of a term loan of \$300.0 million (Term Loan B). We recorded an \$18,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount.

Table of Contents**Equity**

On September 2, 2014, we announced a quarterly distribution in the amount of \$0.0625 per share on Class A and Class B common stock. The quarterly distribution of \$1.6 million was paid on September 30, 2014 to all Class A and Class B common stockholders of record as of September 16, 2014.

Acquisitions

We recorded an increase in the fair value of the contingent earn-out consideration of \$0.1 million associated with our December 2013 acquisition of Twitchy.com, which is reflected in our results of operations for the three months ending September 30, 2014. The increase was based on actual page views that exceeded those estimated at the time of our projections. We increased our future page view estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 1.25 years.

We recorded an increase in the fair value of the contingent earn-out consideration of \$0.5 million associated with Eagle entities, which is reflected in our results of operations for the three months ending September 30, 2014. The increase was based on actual revenues earned from Eagle entities in excess of those estimated at the time of our projections. We increased our future revenue estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 2.50 years.

Net Broadcast Revenue

| | Three Months Ended September 30, | | | | | |
|------------------------------------|----------------------------------|------------------|-----------|----------|-------------------------------|-------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Net Broadcast Revenue | \$ 46,015 | \$ 46,962 | \$ 947 | 2.1% | 78.7% | 67.5% |
| Same Station Net Broadcast Revenue | \$ 46,015 | \$ 46,491 | \$ 476 | 1.0% | | |

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

| | Three Months Ended September 30, | | | |
|---------------------|----------------------------------|-----------|-------|----------------------------|
| | 2013 | | 2014 | |
| | <i>(Dollars in thousands)</i> | | | |
| Block program time: | | | | |
| National | | \$ 11,367 | 24.7% | 11,326 24.1% |
| Local | | 8,099 | 17.6% | 8,704 18.5% |

| | | | | |
|-----------------------|----------|--------|---------------|---------------|
| | 19,466 | 42.3% | 20,030 | 42.6% |
| Advertising: | | | | |
| National | 3,203 | 7.0% | 3,816 | 8.1% |
| Local | 15,752 | 34.2% | 15,111 | 32.2% |
| | 18,955 | 41.2% | 18,927 | 40.3% |
| Infomercials | 1,069 | 2.3% | 977 | 2.1% |
| Network | 3,835 | 8.3% | 3,992 | 8.5% |
| Other | 2,690 | 5.8% | 3,036 | 6.5% |
| Net broadcast revenue | \$46,015 | 100.0% | 46,962 | 100.0% |

The increase in block programming revenue of \$0.6 million resulted from an increase in local programming from our News Talk, Christian Teaching & Talk and Spanish Christian Teaching & Talk format stations. The increase reflects growth in the number of programmers featured on-air with corresponding increases in demand for premium time slots resulting in the realization of higher rates.

We generated political advertising revenue of \$0.5 million associated with upcoming local and congressional elections. Excluding this political revenue, total advertising revenue decreased \$0.4 million due to a lower demand for advertising primarily at the local level.

Declines in infomercial revenues of \$0.1 million reflect our ongoing efforts to rebrand our stations. We continue to promote our stations through local events and speaking engagements that allow us to focus on programming and content consistent with our company values and move away from infomercials that we believe are of less interest to our listeners.

The increase in network revenues includes an increase of \$0.4 million associated with political based advertisements across our national platform. The political revenues were partially offset with declines in network compensation.

Other revenue includes a \$0.3 million increase in listener purchase program revenue, a popular on-air promotion that offers our listeners access to special discounts and incentives from local advertisers.

Table of Contents**Net Internet and e-commerce Revenue**

| | Three Months Ended September 30, | | | | | |
|-------------------------------------|---|------------------|-----------|----------|-------------------------------|--------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Net Internet and e-commerce Revenue | \$ 9,390 | \$ 14,511 | \$ 5,121 | 54.5% | 16.1% | 20.8% |

We continue to acquire and build websites to deliver relevant content to our audience. On January 10, 2014, we acquired and began operating Eagle Financial Publications, Eagle Wellness and Regnery Publishing, which has an e-book segment, each of which is reported in our Internet and e-commerce segment. During 2013, we acquired Christnotes.org, Godupdates.org and Twitchy.com which we began operating on December 10, 2013. The \$5.1 million increase in Internet and e-commerce revenues includes \$4.3 million of revenue associated with the Eagle entities and approximately \$0.2 million of revenue from Twitchy.com. On all other digital platforms, advertising and remnant sales increased \$0.6 million due to a higher volume of advertisements and remnant sales.

Net Publishing Revenue

| | Three Months Ended September 30, | | | | | |
|------------------------|---|-----------------|-----------|----------|-------------------------------|--------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Net Publishing Revenue | \$ 3,071 | \$ 8,130 | \$ 5,059 | 164.7% | 5.3% | 11.7% |

Our acquisition of Regnery Publishing on January 10, 2014 represents a key opportunity for our publishing segment. Regnery Publishing generated \$5.0 million in publishing revenue comprised of \$7.7 million in gross sales (exclusive of e-books) less estimated sales returns and allowances of \$2.7 million during the three month period ending September 30, 2014. Xulon Press, our print-on-demand book publisher, generated an increase of \$0.1 million in publishing fees due to an increase in the number of authors utilizing these services. Our print magazines remain challenged with declining subscriber levels, showing a decrease in subscriber and advertising revenues of \$0.2 million due to lower distribution levels and number of advertisers.

Broadcast Operating Expenses

| | Three Months Ended September 30, | | | | | |
|---|---|------------------|-----------|----------|-------------------------------|--------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Broadcast Operating Expenses | \$ 30,847 | \$ 32,596 | \$ 1,749 | 5.7% | 52.8% | 46.8% |
| Same Station Broadcast Operating Expenses | \$ 30,847 | \$ 32,048 | \$ 1,201 | 3.9% | | |

Broadcast operating expenses reflect higher variable expenses associated with higher revenues, including a \$0.7 million increase in personnel-related costs that includes sales commissions, a \$0.4 million increase in advertising and event costs, a \$0.4 million increase in professional services, a \$0.1 million increase in facility-related costs from additional locations acquired, a \$0.1 million increase in music license fees and a \$0.1 million increase in travel costs, including acquisition-related site visits offset by a \$0.2 million decrease in bad debt expenses.

Internet and e-commerce Operating Expenses

Three Months Ended September 30,

| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
|--|-------------------------------|------------------|-----------|----------|------------------------|--------------|
| | <i>(Dollars in thousands)</i> | | | | % of Total Net Revenue | |
| Internet and e-commerce Operating Expenses | \$ 6,644 | \$ 10,931 | \$ 4,287 | 64.5% | 11.4% | 15.7% |

We utilize cost and operational efficiencies where possible by consolidating administrative and technical support, as well as the use of shared facilities and other resources. During 2014, we acquired Eagle Financial Publications, Eagle Wellness and Regnery Publishing, which has an e-book segment, the expenses of which are reported as Internet operating expenses. Increases in Internet operating expenses of \$4.3 million include \$3.1 million of operating costs incurred by Eagle entities. Across all other digital platforms, we see higher variable expenses consistent with higher revenues, including a \$0.6 million increase in personnel and related costs that includes sales commissions, a \$0.4 million increase in streaming and hosting expense, and a \$0.2 million increase in advertising.

Publishing Operating Expenses

| | Three Months Ended September 30, | | | | | |
|-------------------------------|---|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Publishing Operating Expenses | \$ 3,301 | \$ 6,766 | \$ 3,465 | 105.0% | 5.6% | 9.7% |

During 2014, we acquired Regnery Publishing, a book publisher reported within our publishing segment exclusive of e-book operations. We began operating Regnery Publishing on January 10, 2014 and recognized \$3.7 million of expenses associated with this entity during the three month period ending September 30, 2014. Xulon Press, our print-on-demand book publisher, incurred higher variable costs of \$0.3 million, including commissions, associated with revenue growth, partially offset by a \$0.1 million decline in bad debt expense. Operating expenses incurred by our print magazines declined by \$0.3 million, including lower costs of sales of \$0.1 million consistent with the revenue declines.

Table of Contents**Corporate Expenses**

| | Three Months Ended September 30, | | | | | |
|--------------------|---|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Corporate Expenses | \$ 4,951 | \$ 5,254 | \$ 303 | 6.1% | 8.5% | 7.5% |

Corporate expenses include shared general and administrative services and unallocated expenses. Increases over the same period of the prior year include \$0.4 million of personnel-related costs offset by a \$0.1 million reduction in facility-related costs. While these increases in shared general and administrative services are consistent with our acquisition related growth and development, we continue to seek cost effective ways to reduce our overhead costs and expenses.

Depreciation Expense

| | Three Months Ended September 30, | | | | | |
|----------------------|---|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Depreciation Expense | \$ 3,089 | \$ 3,141 | \$ 52 | 1.7% | 5.3% | 4.5% |

Depreciation expense is consistent with that of the same period of the prior year.

Amortization Expense

| | Three Months Ended September 30, | | | | | |
|----------------------|---|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Amortization Expense | \$ 695 | \$ 1,530 | \$ 835 | 120.1% | 1.2% | 2.2% |

Our acquisition activity, including Christnotes.org, Godupdates.org and Twitchy.com in 2013 and Eagle in January 2014 included intangible assets such as advertising agreements, customer lists and domain names, with estimated useful lives ranging from one to five years. Amortization expense increases over the life of these assets based on the acquisition date.

Change in the Estimated Fair Value of Contingent Earn-Out Consideration

| | Three Months Ended September 30, | | | | | |
|---|---|---------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Change in the estimated fair value of contingent earn-out consideration | \$ | \$ 545 | \$ 545 | 100.0% | % | % |

We recorded an increase in the fair value of the contingent earn-out consideration of \$0.1 million associated with our December 2013 acquisition of Twitchy.com, which is reflected in our results of operations for the three months ending

September 30, 2014. The increases were based on actual page views that exceeded those estimated at the time of our projections. We increased our future page view estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 1.25 years.

We recorded increases in the fair value of the contingent earn-out consideration of \$0.5 million associated with the acquisition of Eagle entities, which is reflected in our results of operations for the three months ending September 30, 2014. The increases were based on actual revenues earned from Eagle entities in excess of those estimated at the time of our projections. We increased our future revenue estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 2.50 years.

Any changes in the estimated fair value of the contingent earn-out consideration, up to the total contractual amount, will be reflected in our results of operations in future periods as they are identified. Changes in the fair value of the contingent earn-out consideration may materially impact and cause volatility in our future operating results.

(Gain) loss on the Sale or Disposal of Assets

| | Three Months Ended September 30, | | | | | |
|---|---|---------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| (Gain) loss on the sale or disposal of assets | \$ (25) | \$ (7) | \$ 18 | (72.0)% | % | % |

The net loss on disposal of assets for the three months ended September 30, 2014 represents various fixed asset and equipment disposals. The net loss on the sale or disposal of assets for the same period of the prior year includes \$0.1 million of insurance proceeds for damages at one of our stations offset by various fixed asset and equipment disposals.

Table of Contents**Other Income (Expense)**

| | Three Months Ended September 30, | | | | | |
|--|---|---------|-----------|-----------|-------------------------------|--------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Interest Income | \$ 16 | \$ 2 | \$ (14) | (87.5)% | % | % |
| Interest Expense | (3,770) | (4,139) | (369) | 9.8% | (6.4)% | (5.9)% |
| Change in the fair value of interest rate swap | (1,033) | 1,046 | 2,079 | (201.3)% | (1.8)% | 1.5% |
| Loss on early retirement of long-term debt | (16) | (18) | (2) | 12.5% | % | % |
| Net miscellaneous income and (expenses) | 4 | 572 | 568 | 14,200.0% | % | 0.8% |

Interest income represents earnings on excess cash. Interest expense reflects an increase of \$0.4 million due to interest payments associated with our interest rate swap. The change in the fair value of interest rate swap reflects the mark-to-market fair value adjustment of the interest rate swap agreement that we entered into on March 28, 2013.

Net miscellaneous income and expenses includes \$0.2 million of royalty income and fees for our real estate properties, \$0.2 million of insurance proceeds, and \$0.2 million received in an eminent domain settlement.

The loss on early retirement of long-term debt reflects unamortized discount on redemptions of our Term Loan B.

Provision for (Benefit from) Income Taxes

| | Three Months Ended September 30, | | | | | |
|---|---|----------|-----------|----------|-------------------------------|------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Provision for (benefit from) income taxes | \$ (1,159) | \$ 2,567 | \$ 3,726 | (321.5)% | (2.0)% | 3.7% |

In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740 *Income Taxes*, our tax provision for income taxes was \$2.6 million for the three months ended September 30, 2014 compared to a benefit of \$1.2 million for the same period of the prior year. The increase in our provision was due the \$6.3 million pre-tax income from continuing operations as compared to \$4.2 million for the same period of the prior year net of the expiration of certain state statute of limitations for prior year deductions and carryovers. The provision for income taxes as a percentage of income before income taxes, or the effective tax rate was 40.7% for the three months ended September 30, 2014 compared to (27.8%) for the same period of the prior year. The effective tax rate for each period differs from the federal statutory income rate of 35.0% due to the effect of state income taxes, certain expenses that are not deductible for tax purposes, and changes in the valuation allowance from the utilization of certain state net operating loss carryforwards.

Loss From Discontinued Operations, Net of Tax**Three Months Ended September 30,**

| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
|---|-------------------------------|-------------|-----------|----------|-------------------------------|-------------|
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Loss from discontinued operations, net of tax | \$ (11) | \$ 11 | \$ 11 | (100.0)% | % | % |

The loss from discontinued operations for the three months ended September 30, 2013 relates to expenses associated with facilities previously occupied by Samaritan Fundraising, which ceased operations in December 2011.

Net Income (Loss)

| | Three Months Ended September 30, | | | | | |
|-------------------|---|-----------------|------------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Net Income (loss) | \$ 5,323 | \$ 3,743 | \$ (1,580) | (29.7)% | 9.1% | 5.4% |

We recognized net income of \$3.7 million for the three months ending September 30, 2014 compared to \$5.3 million in the same period of the prior year. The change reflects the \$0.2 million decline in income from continuing operations due to higher operating expenses, a \$3.8 million increase in our tax provision and a \$0.3 million increase in interest expense offset by a \$2.0 million decrease in the charge associated with the change in fair value of our swap agreement.

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Nine months ended September 30, 2014 compared to the nine months ended September 30, 2013

The following factors affected our results of operations and cash flows for the nine months ended September 30, 2014 as compared to the same period of the prior year:

Financing

On September 29, 2014, we repaid \$5.0 million in principal on our Term Loan B and paid interest due as of that date. We recorded an \$18,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount.

On March 31, 2014, we repaid \$2.3 million in principal on our Term Loan B and paid interest due as of that date. We recorded an \$8,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount.

Equity

On September 2, 2014, we announced a quarterly distribution in the amount of \$0.0625 per share on Class A and Class B common stock. The quarterly distribution of \$1.6 million was paid on September 30, 2014 to all Class A and Class B common stockholders of record as of September 16, 2014.

On May 27, 2014, we announced a quarterly distribution in the amount of \$0.06 per share on Class A and Class B common stock. The quarterly distribution of \$1.5 million was paid on June 30, 2014 to all Class A and Class B common stockholders of record as of June 16, 2014.

On March 6, 2014, we announced a quarterly distribution in the amount of \$0.0575 per share on Class A and Class B common stock. The quarterly distribution of \$1.4 million was paid on March 31, 2014 to all Class A and Class B common stockholders of record as of March 17, 2014.

Acquisitions

On June 6, 2014, we made an early payment of \$1.5 million in cash against the \$2.5 million deferred payment liability due January 2015 for our acquisition of entities of Eagle Publishing.

On May 22, 2014, we completed the acquisition of radio station WOCN-AM, Miami, Florida and the related transmitter site for \$2.5 million in cash.

On May 6, 2014, we completed the acquisition of WRTH-FM (formerly WOLT-FM) in Greenville, South Carolina for \$1.1 million in cash.

On April 14, 2014, we completed the acquisition of three FM translators for \$0.4 million in cash. The FM translators will serve our Orlando, Florida, Tampa, Florida and Omaha, Nebraska markets.

On February 7, 2014, we completed the acquisition of radio stations KDIS-FM, Little Rock, Arkansas and KRDY-AM, San Antonio, Texas for \$2.0 million in cash.

We recorded increases in the fair value of the contingent earn-out consideration of \$0.3 million associated with our December 2013 acquisition of Twitchy.com, which is reflected in our results of operations for the nine months ending September 30, 2014. The increases were based on actual page views that exceeded those estimated at the time of our projections. We increased our future page view estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 1.25 years. We may pay up to an additional \$1.0 million of contingent earn-out consideration over the remaining earn-out period based on the achievement of certain page view milestones established in the purchase agreement. Any changes in the estimated fair value of the contingent earn-out consideration, up to the contracted amount, will be reflected in our results of operations in future periods as they are identified.

On January 10, 2014, we acquired the entities of Eagle Publishing, including Regnery Publishing, HumanEvents.com, Redstate.com, Eagle Financial Publications and Eagle Wellness. We began operating these entities as of the closing date. The base purchase price was \$8.5 million, with \$3.5 million paid in cash upon closing, and deferred payments of \$2.5 million due January 2015 and \$2.5 million due January 2016. We paid an additional \$0.4 million of costs upon closing associated with liabilities incurred by the seller. The deferred payments due January 2015 and January 2016 are recorded at their present value of \$0.9 million and \$2.3 million, respectively, with the discount being amortized to non-cash interest expense over the payment term using the effective interest method.

We may pay up to an additional \$8.5 million of contingent earn-out consideration over the next three years based on the achievement of certain revenue benchmarks established for calendar years 2014, 2015 and 2016 for each of the Eagle entities. On January 10, 2014, we recorded an estimate of contingent earn-out consideration payable upon achievement of certain revenue benchmarks over a three year period related to the acquisition of the Eagle entities. Using a probability-weighted discounted cash flow model, we recorded the estimated fair value of the \$8.5 million total contingent earn-out consideration at the present value of \$2.0 million as of the closing date. There were no changes in our estimates as of the three months ending March 31, 2014.

We recorded increases in the fair value of the contingent earn-out consideration of \$0.6 million associated with Eagle entities, which is reflected in our results of operations for the nine months ending September 30, 2014. The increases were based on actual revenues earned from Eagle entities in excess of those estimated at the time of our projections. We increased our future revenue estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will

continue to review our estimates quarterly over the remaining earn-out period of 2.50 years. Any changes in the estimated fair value of the contingent earn-out consideration, up to the total contractual amount, will be reflected in our results of operations in future periods as they are identified.

Table of Contents**Net Broadcast Revenue**

| | Nine Months Ended September 30, | | | | 2013 | | 2014 | |
|------------------------------------|--|-------------------|-----------|----------|------------------------|--|-------------|--|
| | 2013 | 2014 | Change \$ | Change % | (Dollars in thousands) | | | |
| | | | | | % of Total Net Revenue | | | |
| Net Broadcast Revenue | \$ 136,287 | \$ 140,393 | \$ 4,106 | 3.0% | 78.2% | | | |
| Same Station Net Broadcast Revenue | \$ 136,238 | \$ 139,475 | \$ 3,237 | 2.4% | | | | |

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

| | Nine Months Ended September 30, | | | | |
|----------------------------|--|------------|--------|------------------------|---------------|
| | 2013 | 2014 | | (Dollars in thousands) | |
| Block program time: | | | | | |
| National | | \$ 33,135 | 24.3% | 33,660 | 24.0% |
| Local | | 23,889 | 17.5% | 25,350 | 18.1% |
| | | 57,024 | 41.8% | 59,010 | 42.1% |
| Advertising: | | | | | |
| National | | 9,934 | 7.3% | 11,252 | 8.0% |
| Local | | 46,738 | 34.3% | 46,658 | 33.2% |
| | | 56,672 | 41.6% | 57,910 | 41.2% |
| Infomercials | | 3,943 | 2.9% | 3,104 | 2.2% |
| Network | | 11,086 | 8.1% | 11,892 | 8.5% |
| Other | | 7,562 | 5.6% | 8,477 | 6.0% |
| Net broadcast revenue | | \$ 136,287 | 100.0% | 140,393 | 100.0% |

The increase in block programming revenue increased \$2.0 million, of which \$0.8 million was generated from national ministries, primarily on our Christian Teaching & Talk format stations, \$0.7 million was generated on our News Talk format stations, \$0.3 million was generated from our local programming on our Spanish Christian Teaching & Talk format stations, and \$0.2 million was generated from our business format stations. The increases reflect a greater number of programmers featured on-air with corresponding increases in demand for premium time slots that results in realization of higher rates.

Total advertising revenue increased \$1.2 million of which \$1.1 million was generated from political based advertisements associated with local and congressional elections. The remaining \$0.1 million increase was generated by SMR and VMR primarily from national spot sales.

Declines in infomercial revenues of \$0.8 million reflect our ongoing effort to rebrand our stations. We continue to promote our stations through local events and speaking engagements that allow us to focus on programming and content consistent with our company values and move away from infomercials that we believe are not of interest to our listeners.

The increase in network revenues of \$0.8 million reflects an increase of \$0.3 million associated with political based advertisements across our national platform and an increase of \$0.5 million in compensation received for network programs in select larger markets distribution of SRN programming.

Other revenue includes a \$0.7 million increase in listener purchase program revenue, a popular on-air promotion that offers our listeners access to special discounts and incentives from local advertisers and a \$0.1 million increase in event revenue based on higher attendance and sponsorships for local events, including concerts and speaking events.

Table of Contents**Net Internet and e-commerce Revenue**

| | Nine Months Ended September 30, | | | | | |
|-------------------------------------|---------------------------------|------------------|-----------|----------|------------------------|--------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | % of Total Net Revenue | |
| Net Internet and e-commerce Revenue | \$ 29,012 | \$ 41,811 | \$ 12,799 | 44.1% | 16.7% | 20.8% |

We continue to acquire and build websites to deliver relevant content to our audience. On January 10, 2014, we acquired and began operating Eagle Financial Publications, Eagle Wellness and Regnery Publishing, which has an e-book segment, each of which is reported in our Internet and e-commerce segment. During 2013, we acquired Christnotes.org, Godupdates.org as well as Twitchy.com which we began operating on December 10, 2013. The \$12.8 million increase in Internet and e-commerce revenues includes \$10.4 million of revenue associated with Eagle entities and approximately \$0.4 million of revenue from Twitchy.com. Advertising and remnant sales increased \$2.2 million based on higher sales volume partially offset by a \$0.2 million decline in video and graphic downloads.

Net Publishing Revenue

| | Nine Months Ended September 30, | | | | | |
|------------------------|---------------------------------|------------------|-----------|----------|------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | % of Total Net Revenue | |
| Net Publishing Revenue | \$ 8,941 | \$ 18,369 | \$ 9,428 | 105.4% | 5.1% | 9.2% |

Our acquisition of Regnery Publishing on January 10, 2014 represents a key opportunity for our publishing segment. Regnery Publishing generated \$8.5 million in net book sales revenue, comprised of \$13.6 million in gross sales exclusive of e-books, less estimated sales returns and allowances of \$5.1 million and \$0.3 million in other revenues, including bulk sales, shipping and handling and other fees. Xulon Press, our print-on-demand book publisher, generated an increase of \$0.5 million in publishing fees due to an increase in the number of authors utilizing these services. Print magazine revenue remained challenged with at \$0.2 million decline in subscription and advertising revenue due to a lower number of subscribers and lower distribution levels.

Broadcast Operating Expenses

| | Nine Months Ended September 30, | | | | | |
|---|---------------------------------|------------------|-----------|----------|------------------------|--------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | % of Total Net Revenue | |
| Broadcast Operating Expenses | \$ 91,258 | \$ 97,695 | \$ 6,437 | 7.1% | 52.4% | 48.7% |
| Same Station Broadcast Operating Expenses | \$ 91,139 | \$ 96,505 | \$ 5,366 | 5.9% | | |

Broadcast operating expenses reflect higher variable costs associated with higher revenues, including a \$2.4 million increase in personnel-related costs that includes sales commissions, a \$1.9 million increase in advertising and event costs, a \$0.9 million increase in professional services, a \$0.8 million increase in facility-related costs due to additional locations acquired, a \$0.3 million increase in music license fees, a \$0.3 million increase in travel costs including acquisition-related site visits and a \$0.2 million increase in production and programming expense partially offset by a \$0.3 million decline in bad debt expense.

Internet and e-commerce Operating Expenses

| | Nine Months Ended September 30, | | | | | |
|-----------------------------|--|------------------|--------------|----------|-------------------------------|--------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Internet Operating Expenses | \$ 20,372 | \$ 30,811 | \$ 10,439 | 51.2% | 11.7% | 15.4% |

We utilize cost and operational efficiencies where possible by consolidating administrative and technical support, as well as the use of shared facilities and other resources. During 2014, we acquired Eagle Financial Publications, Eagle Wellness and Regnery Publishing, which has an e-book segment, the expenses of which are reported as Internet operating expenses. The increase in operating expenses of \$10.4 million includes \$7.1 million of operating costs incurred by the Eagle entities. Across all other digital platforms, we see higher variable expenses consistent with higher revenues, including an increase of \$1.8 million in personnel related costs that includes sales commissions, a \$1.3 million increase in streaming and hosting expenses, a \$0.3 million increase in advertising expenses and a \$0.1 million increase in bad debt expense partially offset by a \$0.1 million decline in royalties.

Publishing Operating Expenses

| | Nine Months Ended September 30, | | | | | |
|-------------------------------|--|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Publishing Operating Expenses | \$9,776 | \$17,624 | \$ 7,848 | 80.3% | 5.6% | 8.8% |

During 2014, we acquired Regnery Publishing, a book publisher reported within our publishing segment exclusive of e-book operations. We began operating Regnery Publishing on January 10, 2014 and recognized \$7.9 million of expenses associated with this entity. Xulon Press, our print on demand book publisher, incurred higher variable costs associated with revenue growth, including an increase of \$0.3 million in personnel-related costs due to increases in employee headcount and hours worked to meet production demands. These increases were partially offset by a \$0.3 million decline in operating expenses including printing and mailing costs associated with our print magazines.

Table of Contents**Corporate Expenses**

| | Nine Months Ended September 30, | | | | | |
|--------------------|--|------------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Corporate Expenses | \$ 15,839 | \$ 17,542 | \$ 1,703 | 10.8% | 9.1% | 8.7% |

Corporate expenses include shared general and administrative services and unallocated expenses. Increases in these costs over the same period of the prior year include a \$1.4 million increase in personnel-related costs, a \$0.3 million increase in travel and a \$0.2 million increase in acquisition related costs that were partially offset by a \$0.3 million decline in non-cash stock-based compensation expense. While these increases in shared general and administrative services are consistent with our acquisition related growth and development, we continue to seek cost effective ways to reduce our overhead costs and expenses.

Depreciation Expense

| | Nine Months Ended September 30, | | | | | |
|----------------------|--|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Depreciation Expense | \$ 9,313 | \$ 9,437 | \$ 124 | 1.3% | 5.3% | 4.7% |

Depreciation expense increased slightly due to recent acquisition activity.

Amortization Expense

| | Nine Months Ended September 30, | | | | | |
|----------------------|--|-----------------|-----------|----------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Amortization Expense | \$ 2,076 | \$ 4,667 | \$ 2,591 | 124.8% | 1.2% | 2.3% |

Our acquisition activity, including Christnotes.org, Godupdates.org and Twitchy.com in 2013 and Eagle in January 2014, included intangible assets such as advertising agreements, customer lists and domain names, with estimated useful lives ranging from one to five years. Amortization expense increases over the life of these assets based on the acquisition date.

Change in the Estimated Fair Value of Contingent Earn-Out Consideration

| | Nine Months Ended September 30, | | | | | |
|---|--|---------------|-----------|---------------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Change in the estimated fair value of contingent earn-out consideration | \$ | \$ 914 | \$ 914 | 100.0% | % | % |

We recorded increases in the fair value of the contingent earn-out consideration of \$0.3 million associated with our December 2013 acquisition of Twitchy.com, which is reflected in our results of operations for the nine months ending September 30, 2014. The increases were based on actual page views that exceeded those estimated at the time of our projections. We increased our future page view estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 1.25 years. We may pay up to an additional \$1.0 million of contingent earn-out consideration over the remaining earn-out period based on the achievement of certain page view milestones established in the purchase agreement.

We recorded increases in the fair value of the contingent earn-out consideration of \$0.6 million associated with the acquisition of Eagle entities, which is reflected in our results of operations for the nine months ending September 30, 2014. The increases were based on actual revenues earned from Eagle entities in excess of those estimated at the time of our projections. We increased our future revenue estimates and revised our probability-weighted discounted cash flow model for the updated projections. We will continue to review our estimates quarterly over the remaining earn-out period of 2.50 years.

Any changes in the estimated fair value of the contingent earn-out consideration, up to the total contractual amount, will be reflected in our results of operations in future periods as they are identified. Changes in the fair value of the contingent earn-out consideration may materially impact and cause volatility in our future operating results.

Impairment of Indefinite-Lived Long-Term Assets Other than Goodwill

| | Nine Months Ended September 30, | | | | % of Total Net Revenue | |
|---|--|-------------|------------------|-----------------|-------------------------------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | | |
| Impairment of indefinite-lived long-term assets other than goodwill | \$ 345 | \$ | \$ (345) | (100.0)% | 0.2% | % |

Due to actual operating results that did not meet or exceed our expectations or the assumptions used in our prior valuations, we performed an interim valuation of our mastheads as of June 30, 2013. We determined that the carrying value of the mastheads was less than the estimated fair value. We recorded an impairment charge of \$0.3 million associated with the mastheads in our publishing division during that period. There were no indications of further impairment present as of the period ending September 30, 2014.

Table of Contents**Impairment of Goodwill**

| | Nine Months Ended September 30, | | | | | |
|------------------------|--|------|-----------|-------------------------------|------|------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | <i>% of Total Net Revenue</i> | | |
| Impairment of goodwill | \$ 438 | \$ | \$ (438) | (100.0)% | 0.3% | % |

Due to actual operating results that did not meet or exceed our expectations or the assumptions used in our prior valuations, we performed an interim valuation of our print magazines as of June 30, 2013. We determined that the carrying value of the goodwill was less than the estimated fair value. We recorded an impairment charge of \$0.4 million associated with the goodwill previously recorded in our print magazine division during that period. There were no indications of further impairment present as of the period ending September 30, 2014.

(Gain) loss on the Sale or Disposal of Assets

| | Nine Months Ended September 30, | | | | | |
|---|--|--------|-----------|-------------------------------|------|------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | <i>% of Total Net Revenue</i> | | |
| (Gain) loss on the sale or disposal of assets | \$ (20) | \$ 214 | \$ 234 | (1,170.0)% | % | 0.1% |

The net loss on the sale or disposal of assets for the nine months ended September 30, 2014 includes a \$0.2 million loss associated with the write-off of a receivable from a prior station sale, a \$0.1 million loss due to the relocation of our office and studio facility in our San Francisco market offset by \$0.1 million of insurance proceeds from a claim associated with one of our market as well as other insignificant fixed asset and equipment disposals.

The net loss on disposal of assets for the same period of the prior year includes \$0.1 million of insurance proceeds for damages at one of our stations offset by various fixed asset and equipment disposals.

Other Income (Expense)

| | Nine Months Ended September 30, | | | | | |
|--|--|----------|-----------|-------------------------------|---------|--------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | <i>% of Total Net Revenue</i> | | |
| Interest Income | \$ 52 | \$ 43 | \$ (9) | (17.3)% | % | % |
| Interest Expense | (13,212) | (11,986) | 1,226 | (9.3)% | (7.6)% | (6.0)% |
| Change in the fair value of interest rate swap | 2,545 | (1,423) | (3,968) | (155.9)% | 1.5% | (0.7)% |
| Loss on early retirement of long-term debt | (27,792) | (26) | 27,766 | (99.9)% | (16.0)% | % |
| Net miscellaneous income and (expenses) | 15 | 652 | 637 | 4,246.7% | % | 0.3% |

Interest income represents earnings on excess cash. Interest expense reflects a decrease of \$1.2 million due to the lower cost of capital under our Term Loan B as compared to our Terminated 9 5/8% Notes which were repurchased in March 2013 in a cash tender offer (Tender Offer). The change in the fair value of interest rate swap reflects the

mark-to-market fair value adjustment of the interest rate swap agreement that we entered into on March 28, 2013.

Net miscellaneous income and expenses includes \$0.2 million of royalty income and fees for our real estate properties, \$0.3 million of insurance proceeds, and \$0.2 million received in an eminent domain settlement.

The loss on early retirement of long-term debt of \$27.8 million includes \$26.9 million from the repurchase of \$212.6 million of the outstanding 9 ⁵/₈% Notes and \$0.9 million associated with the termination of our then existing credit facilities in conjunction with the Term Loan B and revolving credit facility of \$25.0 million (Revolver) entered into on March 14, 2013.

Provision for (Benefit from) Income Taxes

| | Nine Months Ended September 30, | | | | | |
|---|---------------------------------|----------|-----------|----------|-------------------------------|------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | | <i>% of Total Net Revenue</i> | |
| Provision for (benefit from) income taxes | \$ (5,506) | \$ 3,492 | \$ 8,998 | (163.4)% | (3.2)% | 1.7% |

In accordance with FASB ASC Topic 740 *Income Taxes*, our tax provision for income taxes was \$3.5 million for the nine months ended September 30, 2014 compared to a tax benefit of \$5.5 million for the same period of the prior year. The increase in our provision was due the \$8.9 million pre-tax income from continuing operations as compared to a \$13.5 million pre-tax loss from continuing operations expirations for the same period of the prior year net of the expiration of certain state statute of limitations for prior year deductions and carryovers. Provision for income taxes as a percentage of income before income taxes, or the effective tax rate, was 39.1% for the nine months ended September 30, 2014 compared to 40.6% for the same period of the prior year. The effective tax rate for each period differs from the federal statutory income rate of 35.0% due to the effect of state income taxes, certain expenses that are not deductible for tax purposes, and changes in the valuation allowance from the utilization of certain state net operating loss carryforwards.

Table of Contents**Loss From Discontinued Operations, Net of Tax**

| | Nine Months Ended September 30, | | | | | |
|---|--|------|-----------|-------------------------------|------|------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | <i>% of Total Net Revenue</i> | | |
| Loss from discontinued operations, net of tax | \$ (26) | \$ | \$ 26 | (100.0)% | % | % |

The loss from discontinued operations for the three months ended September 30, 2013 relates to expenses associated with facilities previously occupied by Samaritan Fundraising, which ceased operations in December 2011.

Net Income (Loss)

| | Nine Months Ended September 30, | | | | | |
|-------------------|--|-----------------|-----------|-------------------------------|--------|-------------|
| | 2013 | 2014 | Change \$ | Change % | 2013 | 2014 |
| | <i>(Dollars in thousands)</i> | | | <i>% of Total Net Revenue</i> | | |
| Net Income (loss) | \$ (8,069) | \$ 5,437 | \$ 13,506 | 167.4% | (4.6)% | 2.7% |

We recognized net income of \$5.4 million for the nine months ending September 30, 2014 compared to a loss of \$8.1 million in the same period of the prior year. The change reflects the impact on the prior year of the \$27.8 million loss from the early retirement of long-term debt and a \$3.1 million decline in income from continuing operations due to higher operating expenses, a \$9.0 million increase in our tax provision, and a \$3.9 million increase in the charge associated with the change in fair value of our swap agreement offset by a \$1.2 million reduction in interest expense resulting from our credit agreement entered March 2013.

NON-GAAP FINANCIAL MEASURES

Regulation G and other SEC regulations define and prescribe the conditions under which certain non-GAAP financial information may be presented. We closely monitor EBIDTA, Adjusted EBITDA, Station Operating Income (SOI), Internet and e-commerce operating income, publishing operating income, and free cash flow, all of which are non-GAAP financial measures. We believe that these non-GAAP measures provide useful information about our core operating results and thus are appropriate to enhance the overall understanding of our financial performance. These non-GAAP measures are intended to provide management and investors a more complete understanding of our underlying operational results, trends and performance. Management uses these non-GAAP measures to evaluate financial results, develop budgets, manage expenditures, and determine employee compensation. Our presentation of this additional information is not to be considered as a substitute for or superior to net income or loss as reported in accordance with GAAP.

The performance of a radio broadcasting company is customarily measured by the ability of its stations to generate station operating income. We define SOI as net broadcast revenue less broadcast operating expenses. Accordingly, changes in net broadcast revenue and broadcast operating expenses, as explained above, have a direct impact on changes in SOI. SOI is not a measure of performance calculated in accordance with GAAP. SOI should be viewed as a supplement to and not a substitute for our results of operations presented on the basis of GAAP. We believe that SOI is a useful non-GAAP financial measure to investors, when considered in conjunction with operating income (most directly comparable GAAP financial measure), because it is generally recognized by the radio broadcasting industry as a tool in measuring performance and in applying valuation methodologies for companies in the media, entertainment and communications industries. SOI is used by investors and analysts who report on the industry to

provide comparisons between broadcasting groups. We use SOI as one of the key measures of operating efficiency, profitability and in our internal review associated with impairment analysis of indefinite-lived intangible assets. SOI does not purport to represent cash provided by operating activities. Our statement of cash flows presents our cash flow activity and our income statement presents our historical performance prepared in accordance with GAAP. SOI as defined by and used by our company is not necessarily comparable to similarly titled measures employed by other companies. Our definition of SOI is not necessarily comparable to similarly titled measures reported by other companies.

We apply a similar methodology to our Internet and e-commerce group and to our publishing group. Internet and e-commerce operating income is defined as Internet and e-commerce revenue minus Internet and e-commerce operating expenses. Publishing operating income is defined as publishing revenue minus publishing operating expenses. Internet and e-commerce operating income and publishing operating income are not measures of performance in accordance with GAAP. Our presentations of these non-GAAP performance measures are not to be considered a substitute for or superior to our operating results reported in accordance with GAAP. Our definitions of Internet and e-commerce operating income and publishing operating income are not necessarily comparable to similarly titled measures reported by other companies.

We define EBITDA as net income before interest, taxes, depreciation, amortization and change in fair value of interest rate swaps. We define Adjusted EBITDA as EBITDA before gains or losses on the disposal of assets, changes in the estimated fair value of contingent earn-out consideration and non-cash compensation expense. EBITDA and Adjusted EBITDA are commonly used by the broadcast and media industry as important measures of performance and are used by investors and analysts who report on the industry to provide meaningful comparisons between broadcasters. EBITDA and Adjusted EBITDA are not measures of liquidity or of performance in accordance with GAAP, and should be viewed as a supplement to and not a substitute for or superior to our results of operations presented on a GAAP basis. Our definitions of EBITDA and Adjusted EBITDA are not necessarily comparable to similarly titled measures reported by other companies.

We define free cash flow as Adjusted EBITDA less capital expenditures, less cash paid for income taxes, less cash paid for interest. We consider free cash flow to be a liquidity measure that provides useful information to management and investors about the amount of cash generated by our operations after capital expenses and cash paid for income taxes and interest. A limitation of free cash flow as a measure of financial performance is that it does not represent the total increase or decrease in our cash balance for the period. We use free cash flow, a non-GAAP measure, both in presenting our results to stockholders and the investment community, and in our internal evaluation and management of the business. Our presentation of free cash flow is not intended to be considered in isolation or as a substitute for the financial information prepared and presented in accordance with GAAP. Our definition of free cash flow is not necessarily comparable to similarly titled measures reported by other companies.

The table below shows select non-GAAP performance indicators that we believe provide useful information to management and investors. We use these non-GAAP measures to evaluate financial results, develop budgets, manage expenditures, and determine employee compensation. Our presentation of this additional information is not to be considered as a substitute for or superior to net income or loss as reported in accordance with GAAP.

| | Three Months | | Nine Months Ended | |
|--|-------------------------------|----------------------|--------------------------|----------------------|
| | Ended | | September 30, | |
| | September 30, | September 30, | September 30, | September 30, |
| | 2013 | 2014 | 2013 | 2014 |
| Non-GAAP Measures | <i>(Dollars in thousands)</i> | | | |
| Station Operating Income | \$ 15,168 | \$ 14,366 | \$ 45,029 | \$ 42,698 |
| Internet and e-commerce operating income | 2,746 | 3,580 | 8,640 | 11,000 |
| Publishing operating income | (230) | 1,364 | (835) | 745 |
| EBIDTA | 12,735 | 14,072 | 8,429 | 36,399 |
| Adjusted EBITDA | 13,095 | 14,972 | 38,539 | 38,829 |
| Free Cash Flow | 6,981 | 9,041 | 17,113 | 19,861 |

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The following table provides a reconciliation these non-GAAP measures to net income (loss) as presented in our Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2013 and 2014:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|------------------|--|------------------|
| | 2013 | 2014 | 2013 | 2014 |
| | <i>(Dollars in thousands) (Unaudited)</i> | | | |
| Reconciliation of Station Operating Income, Internet and E-Commerce Operating Income and Publishing Operating Income to Net Operating Income from Continuing Operations | | | | |
| Station Operating Income | \$ 15,168 | \$ 14,366 | \$ 45,029 | \$ 42,698 |
| Internet and e-commerce operating income | 2,746 | 3,580 | 8,640 | 11,000 |
| Publishing operating income (loss) | (230) | 1,364 | (835) | 745 |
| Less: | | | | |
| Corporate expenses | (4,951) | (5,254) | (15,839) | (17,542) |
| Change in the estimated fair value of contingent earn-out consideration | | (545) | | (914) |
| Depreciation and amortization | (3,784) | (4,671) | (11,389) | (14,104) |
| Impairment of indefinite-lived long-term assets other than goodwill | | | (345) | |
| Impairment goodwill | | | (438) | |
| Loss on disposal of assets | 25 | 7 | 20 | (214) |
| Net operating income from continuing operations | \$ 8,974 | \$ 8,847 | \$ 24,843 | \$ 21,669 |
| Reconciliation of Adjusted EBITDA to EBITDA to Net Income (Loss) | | | | |
| Adjusted EBITDA | \$ 13,095 | \$ 14,972 | \$ 38,539 | \$ 38,829 |
| Less: | | | | |
| Stock-based compensation | (358) | (344) | (1,529) | (1,276) |
| Loss on early retirement of long-term debt | (16) | (18) | (27,792) | (26) |
| Discontinued operations, net of tax | (11) | | (26) | |
| Change in the estimated fair value of contingent earn-out consideration | | (545) | | (914) |
| Impairment of indefinite-lived long-term assets other than goodwill | | | (345) | |
| Impairment of goodwill | | | (438) | |
| Loss on disposal of assets | 25 | 7 | 20 | (214) |
| EBITDA | 12,735 | 14,072 | 8,429 | 36,399 |
| Plus: | | | | |
| Interest income | 16 | 2 | 52 | 43 |
| Less: | | | | |
| Depreciation and amortization | (3,784) | (4,671) | (11,389) | (14,104) |

| | | | | |
|--|-----------------|-----------------|-------------------|-----------------|
| Interest expense | (3,770) | (4,139) | (13,212) | (11,986) |
| Change in fair value of interest rate swap | (1,033) | 1,046 | 2,545 | (1,423) |
| Provision for (benefit from) income taxes | 1,159 | (2,567) | 5,506 | (3,492) |
| Net income (loss) | \$ 5,323 | \$ 3,743 | \$ (8,069) | \$ 5,437 |

Reconciliation of Adjusted EBITDA to Free Cash Flow

| | | | | |
|-----------------------|-----------------|------------------|------------------|------------------|
| Adjusted EBITDA | \$ 13,095 | \$ 14,972 | \$ 38,539 | \$ 38,829 |
| Less: | | | | |
| Cash interest | (3,549) | (4,122) | (13,384) | (10,804) |
| Cash taxes | (5) | (16) | (250) | (254) |
| Capital expenditures | (2,560) | (1,793) | (7,792) | (7,910) |
| Free Cash Flow | \$ 6,981 | \$ 9,041 | \$ 17,113 | \$ 19,861 |

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 acquisitions and upgrades of radio station and network assets, contingent consideration, revenue recognition, sales returns and allowances, allowance for doubtful accounts, goodwill and other non-intangible assets, uncertain tax positions, valuation allowance (deferred taxes), royalty reserves and liabilities, long-term debt and debt covenant compliance, and stock-based compensation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following accounting policies and the related judgments and estimates are critical accounting policies that affect the preparation of our Condensed Consolidated Financial Statements.

Accounting for acquisitions and upgrades of radio station and network assets

A majority of our radio station acquisitions have consisted primarily of the FCC licenses to broadcast in a particular market. We often do not acquire the existing format, or we change the format upon acquisition when we find it beneficial. As a result, a substantial portion of the purchase price for the assets of a radio station is allocated to the broadcast license. We may retain a third-party appraiser to estimate the fair value of these radio stations and networks assets. As part of the valuation and appraisal process, the third-party appraiser prepares a report assigning estimated fair values to the various asset categories in our financial statements. The estimated fair value assigned to the FCC license and other assets are subjective in nature and require careful consideration and judgment. Management reviews the third party reports for reasonableness of the assigned values. We believe that these valuations and analysis provide appropriate estimates of the fair value for net assets acquired.

Property, plant and equipment are recorded at their estimated fair value and depreciated on a straight-line basis over their estimated useful lives. Finite-lived intangible assets are recorded at their estimated fair value and amortized on a straight-line basis over their estimated useful lives. Goodwill, which represents the organizational systems and procedures in place to ensure the effective operation of the entity, may also be recorded and tested for impairment. Costs associated with acquisitions, such as consulting and legal fees, are expensed as incurred in corporate operating

expenses.

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We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC broadcast licenses. Our policy is to capitalize costs incurred up to the point where the project is complete, at which time we transfer the costs to the appropriate fixed asset and/or intangible asset categories. When the completion of a project is contingent upon FCC or other regulatory approval, we assess the probable future benefit of the asset at the time that it is recorded and monitor it through the FCC or other regulatory approval process. In the event the required approval is not considered probable or the project is abandoned, we write-off the capitalized costs of the project.

Accounting for acquisitions and of businesses

We account for business acquisitions in accordance with the acquisition method of accounting as specified in FASB ASC Topic 805 *Business Combinations*. The total acquisition consideration is allocated to assets acquired and liabilities assumed based on their estimated fair values as of the date of the transaction. Estimates of the fair value include discounted estimated cash flows to be generated by the assets and their expected useful lives based on historical experience, market trends and any synergies believed to be achieved from the acquisition. Acquisitions may include contingent consideration, the fair value of which is estimated as of the acquisition date as the present value of the expected contingent payments as determined using weighted probabilities of the payment amounts. We may retain a third-party appraiser to estimate the fair value of the acquired net assets as of the acquisition date. As part of the valuation and appraisal process, the third-party appraiser prepares a report assigning estimated fair values to the various asset categories in our financial statements. These fair value estimates are subjective in nature and require careful consideration and judgment. Management reviews the third party reports for reasonableness of the assigned values. We believe that these valuations and analysis provide appropriate estimates of the fair value for net assets acquired.

Property, plant and equipment are recorded at the estimated fair value and depreciated on a straight-line basis over their estimated useful lives. Finite-lived intangible assets are recorded at their estimated fair value and amortized on a straight-line basis over their estimated useful lives. Goodwill, which represents the organizational systems and procedures in place to ensure the effective operation of the entity, may also be recorded and tested for impairment. Costs associated with acquisitions, such as consulting and legal fees, are expensed as incurred in corporate operating expenses.

Accounting for contingent consideration

Acquisitions may include contingent consideration, the fair value of which is estimated on the acquisition date as the present value of the expected contingent payments, determined using a probability-weighted discounted cash flow model for probabilities of possible future payments. The unobservable inputs used in the determination of the fair value of the contingent consideration include assumptions as to the ability of the acquired businesses to meet the targets and discount rates used in the calculation. Should the actual results of the acquired business increase or decrease as compared to our estimate and assumptions, the fair value of the contingent consideration obligations would increase or decrease, up to the contracted limit, as applicable. Any changes in the estimated fair value of the contingent earn-out consideration, up to the contractual amounts, will be reflected in our results of operations in future periods as they are identified. Changes in the fair value of the contingent earn-out consideration may materially impact and cause volatility in our future operating results.

Revenue recognition

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

Revenues from radio programs and commercial advertising are recognized when the program or advertisement is broadcast. Revenue is reported net of agency commissions, which are calculated based on a stated percentage applied to gross billing. Revenues from the sale of advertising in our magazines are recognized upon publication. Revenue from the sale of subscriptions to our publications and newsletters is recognized over the life of the subscription. Revenue from book sales is recorded when shipment occurs. Revenue from the sale of services is recognized when the services are rendered. Revenue net of estimated sales returns and allowances from product sales are recognized upon shipment.

Multiple-Deliverables

We may enter bundled advertising agreements that include spot advertisements on our radio stations, Internet banner placements, print magazine advertisements and booth space at specific events, or some combination thereof. The multiple deliverables contained in each agreement are accounted for separately over their respective delivery period provided that they are separate units of accounting. The selling price used for each deliverable is based on vendor specific objective evidence or estimated selling price if vendor specific objective evidence is not available. Objective evidence of fair value includes the price charged for each element when sold separately. The estimated selling price is the price that we would transact if the deliverable was sold regularly on a standalone

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basis. Arrangement consideration is allocated at the inception of each arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverable's selling price.

Sales returns

We provide for estimated returns for products sold with the right of return, primarily book sales associated with Regnery Publishing and nutritional products sold through Eagle Wellness. We record an estimate of these product returns as a reduction of revenue in the period of the sale. Our estimates are based upon historical sales returns, the amount of current period sales, economic trends and any changes in customer demand and acceptance of our products. We regularly monitor actual performance to estimated return rates and make adjustments as necessary. Estimated return rates utilized for establishing estimated returns reserves have approximated actual returns experience. However, actual returns may differ significantly, either favorably or unfavorably, from these estimates if factors such as the historical data we used to calculate these estimates do not properly reflect future returns or as a result of changes in economic conditions of the customer and/or its market.

Barter transactions

We may provide advertising time in exchange for certain products, supplies and services. The terms of the exchanges generally permit for the preemption of such broadcast time in favor of advertisers who purchase time on regular terms. We include the value of such exchanges in both net broadcasting revenues and broadcast operating expenses. The value recorded for barter revenues is based upon management's estimate of the fair value of the products, supplies and services received.

Advertising time that our radio stations exchange for goods and/or services is recorded as barter revenue when the advertisement is broadcast at an amount equal to our estimate fair value of what was received. The value of the goods or services received in such barter transactions is charged to expense as used. Barter advertising revenue for the three and nine months ended September 30, 2014 was approximately \$1.4 million and \$4.9 million, respectively, and \$1.7 million and \$4.2 million, respectively, for the same period of the prior year. Barter expenses were approximately the same as barter revenue for each period.

Allowance for doubtful accounts

Our allowance for doubtful accounts is evaluated on a monthly basis and is recorded based on our historical collection experience, the age of the receivables, specific customer information and economic conditions. We also review outstanding balances on an account-specific basis. In general, past due receivable balances are not written-off until all of our collection efforts have been unsuccessful, including use of a recovery agency. 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.

Accounting for discontinued operations

We regularly review underperforming assets to determine if a sale might be a better way to monetize the assets. When a station, group of stations, or other asset groups are considered for sale, we review the transaction to determine if or when the entity qualifies as a discontinued operation in accordance with the criteria of FASB ASC Topic 205-20 *Discontinued Operations*. This pronouncement specifies that the operations and cash flow of the entity disposed of, or to be sold, have or will be eliminated from the ongoing operations as a result of the disposal and that we will not have

significant continuing involvement in the operations after the disposal transaction. For our radio stations, we define a cluster as a group of radio stations operating in the same geographic market, sharing the same building, equipment, and managed by a single general manager. The cluster level is the lowest level for which discrete financial information and cash flows are available and the level reviewed by management to analyze operating results. General Managers are compensated based on the results of their cluster as a whole, not the results of any individual radio stations. We have determined that a radio market qualifies for a discontinued operation when management, having the authority to approve the action, commits to a plan to sell the asset (disposal group), the sale is probable, and the sale will result in the exit of a particular geographic market.

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

The markets and entities that we have accounted for as a discontinued operation are explained in more fully in Note 4 Acquisitions and Recent Transactions.

Table of Contents***Goodwill and other indefinite-lived intangible assets***

Approximately 69% of our total assets as of September 30, 2014 consist of indefinite-lived intangible assets, such as broadcast licenses, goodwill and mastheads, the value of which depends significantly upon the operating results of our businesses. In the case of our radio stations, we would not be able to operate the properties without the related FCC license for each property. Broadcast licenses are renewed with the FCC every eight years for a nominal cost that is expensed as incurred. We continually monitor our stations' compliance with the various regulatory requirements. Historically, all of our broadcast licenses have been renewed at the end of their respective periods, and we expect that all broadcast licenses will continue to be renewed in the future. Accordingly, we consider our broadcast licenses to be indefinite-lived intangible assets in accordance with FASB ASC Topic 350, *Intangibles - Goodwill and Other*. Broadcast licenses account for approximately 94% of our indefinite-lived intangible assets. Goodwill and magazine mastheads account for the remaining 6%. We do not amortize goodwill or other indefinite-lived intangible assets, but rather test for impairment at least annually or more frequently if events or circumstances indicate that an asset may be impaired.

We complete our annual impairment tests in the fourth quarter of each year. We believe that our estimate of the value of our broadcast licenses, mastheads, and goodwill is a critical accounting estimate as the value is significant in relation to our total assets, and our estimates incorporate variables and assumptions that are based on past experiences and judgment about future operating performance of our markets and business segments. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material. The fair value measurements for our indefinite-lived intangible assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. The unobservable inputs are defined in FASB ASC Topic 820 *Fair Value Measurements and Disclosures* as Level 3 inputs discussed in detail in Note 14 to our Condensed Consolidated Financial Statements.

Impairment of long-lived assets

We account for property, plant and equipment in accordance with FASB ASC Topic 360-10, *Property, Plant and Equipment*. We periodically review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. In accordance with authoritative guidance for impairment of long-lived assets, we must estimate the fair value of assets when events or circumstances indicate that they may be impaired. The fair value measurements for our long-lived assets use significant observable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material.

Partial self-insurance on employee health plan

We provide health insurance benefits to eligible employees under a self-insured plan whereby the company pays actual medical claims subject to certain stop loss limits. We record self-insurance liabilities based on actual claims filed and an estimate of those claims incurred but not reported. Any projection of losses concerning our liability is subject to a high degree of variability. Among the causes of this variability are unpredictable external factors such as future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should the actual amount of claims increase or decrease beyond what was anticipated, we may need to adjust our future reserves.

Income taxes and uncertain tax positions

We account for income taxes in accordance with FASB ASC Topic 740 *Income Taxes*. We recorded a decrease in our unrecognized tax benefits of \$0.03 million and \$0.04 million, respectively, as of September 30, 2013 and September 30, 2014. At December 31, 2013, we had \$0.9 million in liabilities for unrecognized tax benefits. Included in this liability amount were \$0.02 million accrued for the related interest, net of federal income tax benefits, and \$0.02 million for the related penalty recorded in income tax expense on our Condensed Consolidated Statements of Operations. We expect to reduce the reserve balance by \$0.4 million over the next twelve months due to statute expirations.

Valuation Allowance (Deferred Taxes)

For financial reporting purposes, we recorded a valuation allowance of \$2.9 million as of September 30, 2014 to offset a portion of the deferred tax assets related to the state net operating loss carryforwards. We regularly review 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 our estimate of the benefit the company will receive from such carryforwards.

Royalty advances to authors

Royalties due to book authors are paid in advance and capitalized. Royalties are expensed as the related book revenues are earned or when we determine that future recovery of the royalty is not likely. We reviewed historical data associated with royalty advances, earnings and recoverability based on actual results of Regnery Publishing. Historically, the longer the unearned portion of an advance

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remains outstanding, the less likely it is that we will recover the advance through the sale of the book. We apply this historical experience to outstanding royalty advances to estimate the likelihood of recovery. A provision was established to expense the balance of any unearned advance which we believe is not recoverable. Our analysis also considers other discrete factors, such as death of an author, any decision to not pursue publication of a title, poor market demand or other relevant factors.

Inventory

Our inventory on hand consists of published books and wellness products. Inventory is recorded at the lower of cost or market as determined on a First-In First-Out (FIFO) cost method.

Inventory reserves

We reviewed historical data associated with book and wellness product inventories held by Regnery Publishing and Eagle Wellness. We utilized this historical data associated with sales returns and allowances and royalty reserves, as well as overall economic conditions and product demand, to estimate the fair value of inventory on hand. A provision has been established to expense the balance of unsold inventory for which we believe the cost to be unrecoverable.

Derivative instruments

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

Under FASB ASC Topic 815 *Derivatives and Hedging* the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income (outside earnings) and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings. The remaining gain or loss on the derivative instrument, if any, shall be recognized currently in earnings.

On March 27, 2013, we entered into an interest rate swap agreement with Wells Fargo Bank, N.A. that began on March 28, 2014 with a notional principal amount of \$150.0 million. The agreement was entered to offset risks associated with the variable interest rate on our Term Loan B. Payments on the swap are due on a quarterly basis with a LIBOR floor of 0.625%. The swap expires on March 28, 2019 at a fixed rate of 1.645%. The interest rate swap agreement was not designated as a cash flow hedge, and as a result, all changes in the fair value are recognized in the current period statement of operations rather than through other comprehensive income. We recorded an asset of \$1.8 million as of September 30, 2014, representing the change in the fair value of the interest rate swap agreement. The swap was valued based on observable inputs for similar assets and liabilities and other observable inputs for interest rates and yield curves, which are classified within Level 2 inputs in the fair value hierarchy described below and in Note 14 to our Condensed Consolidated Financial Statements.

Fair value measurements

FASB ASC Topic 820 *Fair Value Measurements and Disclosures* established a single definition of fair value in generally accepted accounting principles and expanded disclosure requirements about fair value measurements. The provision applies to other accounting pronouncements that require or permit fair value measurements. We adopted the

fair value provisions for financial assets and financial liabilities effective January 1, 2008. The adoption had a material impact on our consolidated financial position, results of operations or cash flows. We adopted fair value provisions for nonfinancial assets and nonfinancial liabilities effective January 1, 2009. This includes applying the fair value concept to (i) nonfinancial assets and liabilities initially measured at fair value in business combinations; (ii) reporting units or nonfinancial assets and liabilities measured at fair value in conjunction with goodwill impairment testing; (iii) other nonfinancial assets measured at fair value in conjunction with impairment assessments; and (iv) asset retirement obligations initially measured at fair value. The adoption of the fair value provisions of FASB ASC Topic 820 to nonfinancial assets and nonfinancial liabilities did not have a material impact on our consolidated financial position, results of operations or cash flows.

The fair value provisions include guidance on how to estimate the fair value of assets and liabilities in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to normal market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate.

The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial

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instrument is new to the market, and the characteristics specific to the transaction. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have less (or no) pricing observability and a higher degree of judgment utilized in measuring fair value.

FASB ASC Topic 820 established a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring fair value. This framework defined three levels of inputs to the fair value measurement process and requires that each fair value measurement be assigned to a level corresponding to the lowest level input that is significant to the fair value measurement in its entirety. The three broad levels of inputs defined by the FASB ASC Topic 820 hierarchy are as follows:

Level 1 Inputs quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date;

Level 2 Inputs inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability; and

Level 3 Inputs unobservable inputs for the asset or liability. These unobservable inputs reflect the entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability, and are developed based on the best information available in the circumstances (which might include the reporting entity's own data).

As of September 30, 2014, the carrying value of cash and cash equivalents, trade accounts receivables, accounts payable, accrued expenses and accrued interest approximates fair value due to the short-term nature of such instruments. The carrying value of other long-term liabilities approximates fair value as the related interest rates approximate rates currently available to the company. The following table summarizes the fair value of our financial assets and liabilities that are measured at fair value:

| | September 30, 2014 | | | |
|----------------------------------|---|----------|---------|---------|
| | Total Fair Value and Fair Value Measurement Carrying Value on Balance Sheet | Category | | |
| | | Level 1 | Level 2 | Level 3 |
| <i>(Dollars in thousands)</i> | | | | |
| Assets: | | | | |
| Cash and cash equivalents | \$ 311 | \$ 311 | \$ | \$ |
| Trade accounts receivable, net | 40,168 | 40,168 | | |
| Fair value of interest rate swap | 1,754 | | 1,754 | |
| Liabilities: | | | | |
| Accounts payable | 5,252 | 5,252 | | |

| | | | |
|---|----------------|---------|-------|
| Accrued expenses including estimated fair value of contingent earn-out consideration | 13,324 | 11,671 | 1,653 |
| Accrued interest | 45 | 45 | |
| Long term liabilities including estimated fair value of contingent earn-out consideration | 4,151 | 2,372 | 1,779 |
| Long-term debt | 286,377 | 286,377 | |

Stock-based compensation

We account for stock-based compensation under the provisions of FASB ASC Topic 718 *Compensation Stock Compensation*. We record equity awards with stock-based compensation measured at the fair value of the award as of the grant date. We determine the fair value of our options using the Black-Scholes option-pricing model that requires the input of highly subjective assumptions, including the expected stock price volatility and expected term of the options granted. The exercise price for options is equal to the closing market price of Salem Communications common stock as of the date of grant. We use the straight-line attribution method to recognize share-based compensation costs over the expected service period of the award. Upon exercise, cancellation, forfeiture, or expiration of stock options, or upon vesting or forfeiture of restricted stock awards, deferred tax assets for options and restricted stock awards with multiple vesting dates are eliminated for each vesting period on a first-in, first-out basis as if each vesting period was a separate award.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas for which management uses estimates include: (1) asset impairments, including broadcasting licenses, goodwill and other indefinite-lived intangible assets; (2) income tax valuation allowances; (3) uncertain tax positions; (4) allowance for doubtful accounts; (5) inventory reserves; (6) reserves for royalty advances; (7) self-insurance reserves; (8) fair value of equity awards; (9) estimated lives for tangible and intangible assets; (10) fair value measurements; (11) contingency reserves; (12) probabilities associated with the potential for contingent earn-out consideration; and (13) sales returns and allowances. These estimates require the use of judgment as future events and the effect of these events cannot be predicted with certainty. The estimates will change as new events occur, as more experience is acquired and as more information is obtained. We evaluate and update our assumptions and estimates on an ongoing basis and we may consult outside experts to assist as considered necessary.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES**

While our focus continues to be on deleveraging the company, we have completed several strategic acquisitions, including Twitchy.com in December 2013 and Eagle Publishing in January 2014. These acquisitions each contain contingent earn-out arrangements based on future operating results. We believe that these contingent earn-out arrangements provide some degree of protection with regard to our cash outflows should the acquisitions not meet our operational expectations. To date, we have paid \$0.3 million of cash for amounts earned under these contingent earn-out arrangements. We have historically financed acquisitions through borrowings, including borrowings under credit facilities and, to a lesser extent, from operating cash flow and from proceeds on selected asset dispositions. We expect to fund future acquisitions from cash on hand, borrowings under our credit facilities, operating cash flow and possibly through the sale of income-producing assets or proceeds from debt and equity offerings. We have historically funded, and will continue to fund, expenditures for operations, administrative expenses, and capital expenditures from operating cash flow, borrowings under the Revolver and, if necessary, proceeds from the sale of selected assets or radio stations.

In March 2013, we entered into a senior secured credit facility, consisting of the Term Loan B of \$300.0 million and the Revolver of \$25.0 million, repurchased or redeemed all of the \$213.5 million aggregate principal amount of our Terminated 9⁵/₈% Notes, and terminated our prior credit facilities, FCB Loan and our Subordinated Debt due to Related Parties. We believe that the borrowing capacity under the Term Loan B and Revolver allows us to meet our ongoing operating requirements, fund capital expenditures and satisfy our debt service requirements for at least the next twelve months. Since the inception of our Term Loan B, we have repaid \$16.0 million of principal outstanding, exceeding the contractual repayments required to date of \$12.3 million. We expect to incur lower interest expense as a result of the Term Loan B and Revolver as compared to our prior external sources of credit.

We undertake projects from time to time to upgrade our radio station technical facilities and/or FCC broadcast licenses, expand our Internet offerings, improve our facilities and upgrade our computer infrastructures. The nature and timing of these upgrades and expenditures can be delayed or scaled back at the discretion of management. Based on our current plans, we expect to incur additional capital expenditures of approximately \$1.8 million for the remainder of 2014.

In recent years, we have recognized impairment charges on non-amortizable intangible assets, including FCC licenses and mastheads. These impairment charges were non-cash in nature and did not impact our liquidity or compliance with our debt covenants. If actual future results are less favorable than the assumptions and estimates we used in our impairment analysis, we are subject to future impairment charges, the amount of which may be material.

Cash Flows

Cash and cash equivalents increased \$0.2 million to \$0.3 million as of September 30, 2014 compared to \$0.1 million as of December 31, 2013. Working capital decreased \$2.5 million to \$16.7 million as of September 30, 2014, compared to \$19.2 million as of December 31, 2013. During the nine months ending September 30, 2014, the balances outstanding under our consolidated debt agreements ranged from \$286.8 million to \$294.7 million. These balances were ordinary and customary based on our operating and investing cash needs during this time.

The following events impacted our liquidity and capital resources during the nine months ended September 30, 2014:

We repaid \$7.3 million of principal outstanding on the Term Loan B;

Cash paid for acquisitions increased \$5.0 million to \$10.7 million from \$5.7 million for the same period of the prior year;

Capital expenditures increased \$0.1 million to \$7.9 million from \$7.8 million for the same period of the prior year;

Our Days Sales Outstanding, or the average number of days to collect receivables from the date of sale, was consistent at 74 days as of September 30, 2014 and 2013;

We paid cash distributions of \$4.5 million, on our Class A and Class B common stock as compared to \$2.5 million for the same period of the prior year;

Based on the number of shares of Class A and Class B common stock currently outstanding, and the currently approved distribution amount, we expect to pay total annual distributions of approximately \$6.1 million; and

Our net operating income from continuing operations decreased \$3.1 million to \$21.7 million from \$24.8 million for the same period of the prior year.

Table of Contents***Credit Facilities***

Salem Communications Corporation has no independent assets or operations, the subsidiary guarantees are full and unconditional and joint and several, and any subsidiaries of the Salem Communications Corporation other than the subsidiary guarantors are minor.

Term Loan B and Revolving Credit Facility

On March 14, 2013, we entered into a senior secured credit facility, consisting of the Term Loan B of \$300.0 million and \$25.0 million Revolver. The Term Loan B was issued at a discount for total net proceeds of \$298.5 million. The discount is being amortized to non-cash interest expense over the life of the loan using the effective interest method. For each of the three and nine months ended September 30, 2013 and 2014, approximately \$47,000 and \$141,000 respectively, and \$48,000 and \$110,000, respectively, of the discount has been recognized as interest expense.

The Term Loan B has a term of seven years, maturing in March 2020. During this term, the principal amount may be increased by up to an additional \$60.0 million, subject to the terms and conditions of the credit agreement. We are required to make principal payments of \$750,000 per quarter which began on September 30, 2013 for the Term Loan B. Prepayments may be made against the outstanding balance of our Term Loan B. Each repayment of the outstanding Term Loan B is applied ratably to each of the next four principal installments thereof in the direct order of maturity and thereafter to the remaining principal balance in reverse order of maturity.

On September 29, 2014, we repaid \$5.0 million in principal on the Term Loan B and paid interest due as of that date. We recorded an \$18,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount on the principal repaid. On March 31, 2014, we repaid \$2.3 million in principal on the Term Loan B and paid interest due as of that date. We recorded an \$8,000 pre-tax loss on the early retirement of long-term debt related to the unamortized discount on the principal repaid. As of September 30, 2014, accrued interest on the Term Loan B was \$36,000 and there are no quarterly principal payments due in the next twelve months.

Information regarding repayments of our Term Loan B is as follows:

| Date | Principal Paid | Unamortized Discount |
|--------------------|-------------------------------|----------------------|
| | <i>(Dollars in Thousands)</i> | |
| September 29, 2014 | \$ 5,000 | \$ 18 |
| March 31, 2014 | 2,250 | 8 |
| December 30, 2013 | 750 | 3 |
| September 30, 2013 | 4,000 | 16 |
| June 28, 2013 | 4,000 | 14 |

The Revolver has a term of five years, maturing in March 2018. We report outstanding balances on our Revolver as short-term based on use of the Revolver to fund ordinary and customary operating cash needs with repayments made frequently. We believe that the borrowing capacity under our Term Loan B and Revolver allows us to meet our ongoing operating requirements, fund capital expenditures and satisfy our debt service requirements for at least the next twelve months.

Borrowings under the Term Loan B may be made at LIBOR (subject to a floor of 1.00%) plus a spread of 3.50% or Wells Fargo's base rate plus a spread of 2.50%. Borrowings under the Revolver may be made at LIBOR or Wells Fargo's base rate plus a spread determined by reference to our leverage ratio, as set forth in the pricing grid below. If

an event of default occurs under the credit agreement, the applicable interest rate may increase by 2.00% per annum. At September 30, 2014, the blended interest rate on amounts outstanding under the Term Loan B and Revolver was 5.04%.

| Pricing Level | Consolidated Leverage Ratio | Revolver Pricing | |
|---------------|--|------------------|-------------|
| | | Base Rate Loans | LIBOR Loans |
| 1 | Less than 3.00 to 1.00 | 1.250% | 2.250% |
| 2 | Greater than or equal to 3.00 to 1.00 but less than 4.00 to 1.00 | 1.500% | 2.500% |
| 3 | Greater than or equal to 4.00 to 1.00 but less than 5.00 to 1.00 | 1.750% | 2.750% |
| 4 | Greater than or equal to 5.00 to 1.00 but less than 6.00 to 1.00 | 2.000% | 3.000% |
| 5 | Greater than or equal to 6.00 to 1.00 | 2.500% | 3.500% |

The obligations under the credit agreement and the related loan documents are secured by liens on substantially all of the assets of Salem and its subsidiaries, other than certain exceptions set forth in the Security Agreement, dated as of March 14, 2013, among Salem, the subsidiary guarantors party thereto, and Wells Fargo Bank, National Association, as Administrative Agent (the Security Agreement) and such other related loan documents.

With respect to financial covenants, the credit agreement includes a minimum interest coverage ratio, which started at 1.50 to 1.0 and steps up to 2.50 to 1.0 by 2016 and a maximum leverage ratio, which started at 6.75 to 1.0 and steps down to 5.75 to 1.0 by 2017. The credit agreement also includes other negative covenants that are customary for credit facilities of this type, including covenants

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that, subject to exceptions described in the credit agreement, restrict the ability of Salem and its subsidiary guarantors: (i) to incur additional indebtedness; (ii) to make investments; (iii) to make distributions, loans or transfers of assets; (iv) to enter into, create, incur, assume or suffer to exist any liens; (v) to sell assets; (vi) to enter into transactions with affiliates; or (vii) to merge or consolidate with, or dispose of all or substantially all assets to, a third party. As of September 30, 2014, our leverage ratio was 5.42 to 1 compared to our compliance covenant of 6.50 and our interest coverage ratio was 3.44 compared to our compliance ratio of 2.0. We were in compliance with our debt covenants under the credit facility at September 30, 2014.

Terminated Senior Secured Second Lien Notes

On December 1, 2009, we issued \$300.0 million principal amount of our 9 5/8% Notes Senior Secured Second Lien Notes due 2016 (Terminated 9% Notes) at a discount for \$298.1 million resulting in an effective yield of 9.75%. Interest was due and payable on June 15 and December 15 of each year, commencing June 15, 2010 until maturity. We were not required to make principal payments on the Terminated 9 5/8% Notes, which were due in full in December 2016. The Terminated 9 5/8% Notes were guaranteed by all of our existing domestic restricted subsidiaries. Upon issuance, we were required to pay \$28.9 million per year in interest on the then outstanding Terminated 9 5/8% Notes. As of December 31, 2012, accrued interest on the Terminated 9 5/8% Notes was \$0.9 million. The discount was being amortized to interest expense over the term of the Terminated 9 5/8% Notes based on the effective interest method. For the three and nine months ended September 30, 2013, approximately \$0 and \$37,000 of the discount, respectively, was recognized as interest expense.

On March 14, 2013, we tendered for \$212.6 million in aggregate principal amount of the Terminated 9 5/8% Notes for an aggregate purchase price of \$240.3 million, or at a price equal to 110.65% of the face value of the Terminated 9 5/8% Notes in the Tender Offer. We paid \$22.7 million for this repurchase resulting in a \$26.9 million pre-tax loss on the early retirement of long-term debt, which included approximately \$0.8 million of unamortized discount and \$2.9 million of bond issue costs associated with the Terminated 9 5/8% Notes. We issued a notice of redemption to redeem any of the Terminated 9 5/8% Notes that remained outstanding after the expiration date of the Tender Offer. On June 3, 2013, we redeemed the remaining \$0.9 million of the outstanding Terminated 9 5/8% Notes to satisfy and discharge Salem's obligations under the indenture for the Terminated 9% Notes. The carrying value of the Terminated 9 5/8% Notes was \$212.6 million at December 31, 2012. There are no outstanding Terminated 9 5/8% Notes as of the effectiveness of the redemption.

Information regarding repurchases and redemptions of the Terminated 9 5/8% Notes is as follows:

| Date | Principal | Premium | Unamortized | Bond Issue |
|-------------------|-------------------------------|---------|-------------|------------|
| | Redeemed/Repurchased | Paid | Discount | Costs |
| | <i>(Dollars in thousands)</i> | | | |
| June 3, 2013 | \$ 903 | \$ 27 | \$ 3 | \$ |
| March 14, 2013 | 212,597 | 22,650 | 837 | 2,867 |
| December 12, 2012 | 4,000 | 120 | 17 | 57 |
| June 1, 2012 | 17,500 | 525 | 80 | 287 |
| December 12, 2011 | 12,500 | 375 | 62 | 337 |
| September 6, 2011 | 5,000 | 144 | 26 | 135 |
| June 1, 2011 | 17,500 | 525 | 93 | 472 |
| December 1, 2010 | 12,500 | 375 | 70 | 334 |
| June 1, 2010 | 17,500 | 525 | 105 | 417 |

Terminated Senior Credit Facility

On December 1, 2009, we entered into a Revolver (Terminated Revolver). We amended the Terminated Revolver on November 1, 2010 to increase the borrowing capacity from \$30 million to \$40 million. The amendment allowed us to use borrowings under the Revolver, subject to the Available Amount as defined by the terms of the credit agreement, to redeem applicable portions of the Terminated 9 ⁵/₈% Notes. The calculation of the Available Amount also pertained to the payment of dividends when the leverage ratio was above 5.0 to 1.

On November 15, 2011, we completed the Second Amendment of the Terminated Revolver to, among other things, (1) extend the maturity date from December 1, 2012 to December 1, 2014, (2) change the interest rate applicable to LIBOR or the Wells Fargo base rate plus a spread to be determined based on our leverage ratio, (3) allow us to borrow and repay unsecured indebtedness provided certain conditions are met and (4) include step-downs related to our leverage ratio covenant. We incurred \$0.5 million in fees to complete this amendment, which were being amortized over the remaining term of the agreement. The applicable interest rate relating to the amended credit agreement was LIBOR plus a spread of 3.00% per annum or the Base Rate plus a spread of 1.25% per annum, which was adjustable based on our leverage ratio. If an event of default occurred, the interest rate could be increased by 2.00% per annum. Details of the change in our rate based on our leverage ratio were as follows:

| Consolidated Leverage Ratio | Base Rate | Eurodollar Rate Loans | Applicable Fee Rate |
|--|-----------|--------------------------|------------------------|
| Less than 3.25 to 1.00 | 0.75% | 2.25% | 0.40% |
| Greater than or equal to 3.25 to 1.00 but less than 4.50 to 1.00 | 0.75% | 2.50% | 0.50% |
| Greater than or equal to 4.50 to 1.00 but less than 6.00 to 1.00 | 1.25% | 3.00% | 0.60% |
| Greater than or equal to 6.00 to 1.00 | 2.25% | 3.50% | 0.75% |

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The Terminated Revolver included a \$5 million subfacility for standby letters of credit and a subfacility for swingline loans of up to \$5 million, subject to the terms and conditions of the credit agreement relating to the Terminated Revolver. In addition to interest charges outlined above, we paid a commitment fee on the unused balance based on the Applicable Fee Rate in the above table.

The Terminated Revolver was terminated on March 14, 2013 upon entry into our current senior secured credit facility. This termination resulted in a \$0.9 million pre-tax loss on the early retirement of long-term debt related to unamortized credit facility fees. There was no outstanding balance on the Terminated Revolver as of the termination date.

Terminated Subordinated Credit Facility with First California Bank

On May 21, 2012, we entered into a Business Loan Agreement, Promissory Note and related loan documents with First California Bank (the FCB Loan). The FCB Loan was an unsecured, \$10.0 million fixed-term loan with a maturity date of June 15, 2014. The interest rate for the FCB Loan (Interest Rate) was variable and was equal to the greater of: (a) 4.250% or (b) the Wall Street Journal Prime Rate as published in The Wall Street Journal and reported by FCB plus 1%.

We were required to repay the FCB Loan as follows: (a) twenty-three (23) consecutive monthly interest payments based upon the then-current principal balance outstanding at the then-current Interest Rate commencing on September 15, 2012; (b) seven (7) quarterly consecutive principal payments of \$1.25 million each commencing on September 15, 2012; and (c) one (1) final principal and interest payment on June 15, 2014 of all outstanding and unpaid interest and principal as of such maturity date. The FCB Loan could be prepaid at any time subject to a minimum interest charge of fifty dollars (\$50). If an event of default occurred on the FCB Loan, the Interest Rate could have been increased by 5.00% per annum.

The FCB loan was terminated on March 14, 2013 upon entry into our current senior secured credit facility. This termination resulted in a \$33,000 pre-tax loss on the early retirement of long-term debt for unamortized credit facility fees. There was no outstanding balance on the FCB Loan as of the termination date.

Terminated Subordinated Debt due to Related Parties

On November 17, 2011, we entered into subordinated lines of credit Terminated Subordinated Debt due Related Parties with Edward G. Atsinger III, Chief Executive Officer and director of Salem, and Stuart W. Epperson, Chairman of Salem's Board of Directors. Pursuant to the related agreements, Mr. Epperson committed to provide an unsecured revolving line of credit to Salem in a principal amount of up to \$3 million, and Mr. Atsinger committed to provide an unsecured revolving line of credit in a principal amount of up to \$6 million. On May 21, 2012, we also entered into a subordinated line of credit with Roland S. Hinz, a Salem board member. Mr. Hinz committed to provide an unsecured revolving line of credit in a principal amount of up to \$6 million. On September 12, 2012, we amended and restated the original subordinated line of credit with Mr. Hinz to increase the unsecured revolving line of credit by \$6 million for a total line of credit of up to \$12 million.

The proceeds of the Terminated Subordinated Debt due to Related Parties could be used to repurchase a portion of the Terminated 9⁵/₈% Notes. Outstanding amounts under each subordinated line of credit bore interest at a rate equal to the lesser of (1) 5% per annum and (2) the maximum rate permitted for subordinated debt under the Terminated Revolver referred to above plus 2% per annum. Interest was payable at the time of any repayment of principal. In addition, outstanding amounts under each subordinated line of credit were required to be repaid within three (3) months from the time that such amounts were borrowed, with the exception of the subordinated line of credit with

Mr. Hinz, which was to be repaid within six (6) months from the time that such amounts were borrowed. The Terminated Subordinated Debt due to Related Parties did not contain any covenants. On March 14, 2013, we repaid these lines of credit upon entry into our current senior secured credit facility. On April 3, 2013, we provided written notice to Messrs. Atsinger, Epperson and Hinz electing to terminate the Terminated Subordinated Debt due to Related Parties and related agreements effective as of May 3, 2013. There were no outstanding balances on the Terminated Subordinated Debt due to Related Parties as of the termination date.

Table of Contents**Summary of long-term debt obligations**

Long-term debt consisted of the following:

| | As of December 31, 2013 and September 30, 2014 | |
|--------------------------------|--|------------|
| | <i>(Dollars in thousands)</i> | |
| Term Loan B | \$ 289,939 | \$ 282,856 |
| Revolver | | 2,759 |
| Capital leases and other loans | 854 | 762 |
| | 290,793 | 286,377 |
| Less current portion | (3,121) | (2,871) |
| | \$ 287,672 | \$ 283,506 |

In addition to the outstanding amounts listed above, we also have interest payments related to our long-term debt as follows as of September 30, 2014:

Outstanding borrowings of \$284.0 million under the Term Loan B with interest payments due at LIBOR (subject to a floor of 1.00%) plus 3.50% or prime rate plus 2.50%; and

Outstanding borrowings of \$2.8 million under the Revolver, with interest payments due at LIBOR plus 3.00% or at prime rate plus 2.00%.

Other Debt

We have several capital leases related to office equipment. The obligation recorded at December 31, 2013 and September 30, 2014 represents the present value of future commitments under the capital lease agreements.

Maturities of Long-Term Debt

Principal repayment requirements under all long-term debt agreements outstanding at September 30, 2014 for each of the next five years and thereafter are as follows:

| For the Twelve Months Ended September 30, | Amount |
|--|-------------------------------|
| | <i>(Dollars in thousands)</i> |
| 2015 | \$ 2,871 |
| 2016 | 3,095 |
| 2017 | 3,098 |
| 2018 | 3,095 |
| 2019 | 3,091 |
| Thereafter | 271,127 |

| | |
|----|---------|
| \$ | 286,377 |
|----|---------|

Impairment Losses on Goodwill and Indefinite-Lived Intangible Assets

Under FASB ASC Topic 350 *Intangibles - Goodwill and Other*, indefinite-lived intangibles, including broadcast licenses, goodwill and mastheads are not amortized but instead are tested for impairment at least annually, or more frequently if events or circumstances indicate that there may be an impairment. Impairment is measured as the excess of the carrying value of the indefinite-lived intangible asset over its fair value. Intangible assets that have finite useful lives continue to be amortized over their useful lives and are measured for impairment if events or circumstances indicate that they may be impaired. Impairment losses are recorded as operating expenses. We have incurred significant impairment losses in prior periods with regard to our indefinite-lived intangible assets.

The valuation of intangible assets is subjective and based on estimates rather than precise calculations. The fair value measurements of our indefinite-lived intangible assets use significant unobservable inputs that reflect our own assumptions about the estimates that market participants would use in measuring fair value including assumptions about risk. If actual future results are less favorable than the assumptions and estimates we used, we are subject to future impairment charges, the amount of which may be material. Given the current economic environment and uncertainties that can negatively impact our business, there can be no assurance that our estimates and assumptions made for the purpose of our indefinite-lived intangible fair value estimates will prove to be accurate.

OFF-BALANCE SHEET ARRANGEMENTS

We have, from time to time, divested certain of our radio stations and assets. In connection with these divestitures, we often provide representations, warranties and/or indemnities to cover various risks and unknown liabilities, such as environmental liabilities. We cannot estimate the potential liability from such representations, warranties and indemnities because they relate to unknown conditions.

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We indemnify our directors and certain employees as permitted by law. We have not recorded a liability associated with these indemnification arrangements as we historically have not incurred any losses associated with such indemnification obligations. Costs associated with such indemnification obligations may be mitigated by insurance coverage that we maintain; however, such insurance may not cover any of, or may cover only a portion of, the amounts we may be required to pay. In addition, such insurance coverage could change in the future.

We do 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 financial arrangements or other contractually narrow or limited purposes at September 30, 2014. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

As of September 30, 2014, we had no off-balance sheet arrangements.

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 may use derivative instruments only for the purpose of managing risk associated with an asset, liability, committed transaction, or probable forecasted transaction that is identified by management. Our use of derivative instruments may result in short-term gains or losses that may increase the volatility of our earnings.

Under FASB ASC Topic 815 *Derivatives and Hedging* the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income (outside earnings) and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings. The remaining gain or loss on the derivative instrument, if any, shall be recognized currently in earnings.

On March 27, 2013, we entered into an interest rate swap agreement with Wells Fargo Bank, N.A. that began on March 28, 2014 with a notional principal amount of \$150.0 million. The agreement was entered to offset risks associated with the variable interest rate on our Term Loan B. Payments on the swap are due on a quarterly basis with a LIBOR floor of 0.625%. The swap expires on March 28, 2019 at a fixed rate of 1.645%. The interest rate swap agreement was not designated as a cash flow hedge, and as a result, all changes in the fair value are recognized in the current period statement of operations rather than through other comprehensive income. We recorded an asset of \$1.8 million as of September 30, 2014, representing the change in the fair value of the interest rate swap agreement. The swap was valued based on observable inputs for similar assets and liabilities and other observable inputs for interest rates and yield curves, which are classified within Level 2 inputs in the fair value hierarchy described in Note 14 to our Condensed Consolidated Financial Statements.

ITEM 4. CONTROLS AND PROCEDURES.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon such evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2014.

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. We maintain insurance that 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.

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ITEM 1A. RISK FACTORS.

We have included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013 (the 2013 Annual Report), a description of certain risks and uncertainties that could affect our 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 our stock. There are no material changes from the Risk Factors disclosed in the 2013 Annual Report.

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

None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not Applicable

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

See Exhibit Index below.

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SIGNATURES

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

November 7, 2014

SALEM COMMUNICATIONS CORPORATION

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

November 7, 2014

By: /s/ EVAN D. MASYSR
Evan D. Masyr
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Table of Contents**EXHIBIT INDEX**

| Exhibit Number | Exhibit Description | Form | File No. | Date of | Exhibit Number | Filed Herewith |
|---------------------------|---|-------------|-----------------|-------------------------|---------------------------|---------------------------|
| | | | | First Filing | | |
| 10.06.01 | Employment Agreement dated September 15, 2014 between Salem Communications Holding Corporation and Davie A.R. Evans. | 8-K | 000-26497 | 09/19/2014 | 99.1 | |
| 31.1 | Certification of Edward G. Atsinger III Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act. | | | | | X |
| 31.2 | Certification of Evan D. Masyr Pursuant to Rules 13a-14(a) and 15d-14(a) under the Exchange Act. | | | | | X |
| 32.1 | Certification of Edward G. Atsinger III Pursuant to 18 U.S.C. Section 1350. | | | | | X |
| 32.2 | Certification of Evan D. Masyr Pursuant to 18 U.S.C. Section 1350. | | | | | X |
| 101 | The following financial information from the Quarterly Report on Form 10Q for the three and nine months ended September 30, 2014, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Balance Sheets (ii) Condensed Consolidated Statements of Operations (iii) the Condensed Consolidated Statements of Cash Flows (iv) the Notes to the Condensed Consolidated Financial Statements. | | | | | X |