



Opportunity Equity Research

Salem Communications (SALM)

Initiation Report (Date Published 12/29/2017)

Salem Communications (SALM) Stats

\$4.50 Current Price

\$117.7 Market Cap

52 Week Range \$ 3.90 - \$ 8.25

Shares Outstanding: 20.6 million

Enterprise Value: \$373.8 million

Long-Term Debt: \$261.6 million

Institutional Holdings: 41.8% of outstanding

Insider Holdings: 40.9%

Short Interest: 156k shares/1.3% of float

100 Day Avg Volume: 29.7k

Condensed Income Statement

FY (Dec)	Q1	Q2	Q3	Q4	Yr
EPS 15a	\$.01a	\$.14a	\$.08a	\$.20a	\$.43a
EPS 16a	\$.01a	\$.13a	\$.08a	\$.11a	\$.34a
EPS 17e	\$.04a	\$.05a	\$.00a	\$.06e	\$.15e
Rev15a	\$61.9a	\$67.3a	\$67.5a	\$69.1a	\$265.8a
Rev16a	\$64.6a	\$67.8a	\$71.3a	\$70.7a	\$274.3a
Rev17e	\$65.0a	\$66.1a	\$65.4a	\$68.4e	\$268.0e

EV/adj. EBITDA 2014a: 7.8 2015a: 7.3 2016a: 7.3

Stock Chart-Short Term



Stock Chart-Long Term



Company Description: Salem Communications is a diversified media company that includes 118 radio stations, over 100 website properties, a growing mobile app business, and a publishing business. Salem targets Christian and conservative audiences and currently ranks as the third largest radio broadcaster in the top 25 U.S. markets, where about ½ of U.S. adults live.

Opportunity Summary: Selling off post tough recent quarterly results, this stock is trading at a very compelling 7.3 times EV/EBITDA level. Better results from an improved publishing slate over time, added to easier comps as the company moves through the next few quarters, set the stock up for a nice percentage rebound in here.

- Adjusted EBITDA results consistently in the \$50 million plus range since 2013 supports both the debt levels and continued small acquisition growth.
- In May, the company refinanced all of their debt, moving the maturity out a full 7 years to 2024 with a \$255 senior secured note at 6.75% and a \$30 mil 30-year asset backed credit facility, neither with maintenance covenants.
- While recent quarterly results looked rough and were optically challenging after last year's political spending led revenue results, we view this as temporary relative weakness in a cyclical industry.
- A \$.26 current dividend supported by recurring long-term cash flow gives investors a 6%ish yield (treated as a return of capital due to \$151 million federal NOLs).
- Trading at 7.3 times historical normalized EV/EBITDA ratios, as the company continues to pay down debt and take advantage of cheap tuck-in acquisitions, this levered company has the potential for strong equity gains from here.

CEO Name: Edward Atsinger III, CEO, Co-Founder

CFO Name: Evan Masyr, CFO/IR

Greg Edwards, CFA greg@oppequity.com

Company Overview/History:

Salem Communications is a media company with a large broadcasting division including 118 radio stations, a digital media division that includes over 100 highly-trafficked websites and a publishing division that includes Regnery Publishing and Xulon Press. Last year's revenue breakdown was roughly 74% broadcasting (radio stations), 17% digital media, and 9% publishing. Salem is a business that has grown larger over time through acquisitions. The company has acquired 14 radio stations and 28 FM translators since January 2015. Salem is number one in commercial Christian radio broadcasting, with 118 total stations across 40 markets and over 2,900 affiliates. The digital media piece of the business is noted as being the fastest growing piece, with more than 145 million monthly page views across their platform. The publishing business can be rather lumpy, but this business is now large enough that they print over two million books a year and have several authors under contract.

Salem has grown to be the third largest radio broadcaster in the top 25 U.S. markets where about half of U.S. adults live (only iHeartMedia and Entercom/CBS are larger). They now have 73 total stations in 23 of the top U.S. markets. The breakdown of the formats they operate in are: Christian Teaching and Talk, 40 stations + Sirius XM, Christian Music, 13 stations, New Talk, 32 Stations, Spanish Christian Teaching and Talk, 8 stations and Business, 13 stations. 71% of total broadcasting revenue comes from the important Christian demographic.

Although SALM's radio income does rely somewhat on typical radio revenue selling ads into the spot market, programming revenue mix for SALM represents 31% of their total company revenue (a very stable and reliable revenue stream). Renewal rates are higher than 95% annually on this piece of their business, with rate increases in the 2.5-5.0% range typically. Their top ten programmers have averaged thirty plus years on the air—a sign of the resiliency of their model, and an underpinning to a highly recurring revenue stream for the entire company.

The management has always pursued opportunistic acquisitions, with their most recent history including a purchase of 12 Disney radio stations (at a price that they couldn't pass up) and the periodic adds of both new stations and new websites (mostly just smaller sized, tuck-in types of acquisitions). The company has focused on using the broadcasting platform as a synergistic way to increase other business lines as well, adding 41 apps in the digital media space during the 2015-2017 time frame. They have a very long list of web properties as well, many focusing on the Christian and Conservative demographics and a few on investing. Sites include Townhall, CrossCards, Christianity.com, ChristianRadio, DividendInvestor.com, Stock Investor, RedState, Bearing Arms and Conservative Radio.com.

In a fairly recent move, the company refinanced all of their debt, placing a \$255 million private placement at 6.75%. The debt is callable starting in June 2020. This move takes out their maturity profile to 2024 and gives them a lot of flexibility. They were paying lower rates for their previous debt (around 5%), but in a potentially upward moving interest rate environment, management thought it was prudent to lock these rates in and extend the maturity profile.

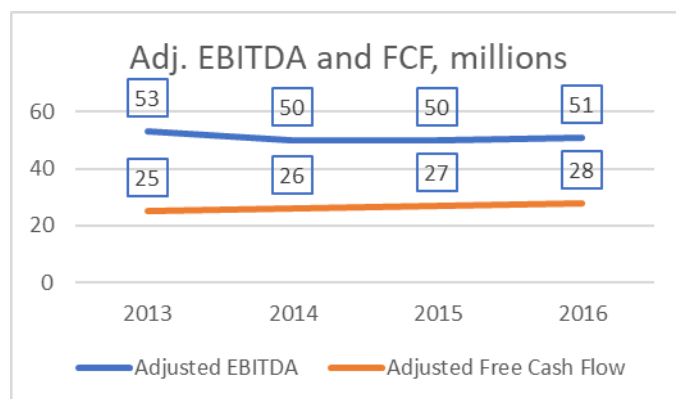
Management Profile:

Salem's management team is led by Edward Atsinger III, CEO and Co-founder. It's Chairman of the Board is Stuart Epperson, another Co-founder. These two leaders and co-founders are still very invested in this business, owning 39.2% of the shares outstanding. The CFO is Evan Masyr (with Salem since 2000). The two presidents are also both long-term management team members: David Santrella, President of Broadcast Media, has been with Salem since 2001 and David Evans, President of New Media, has been with Salem since 2000. The management picture is one of a long-standing team that has been together through the different cycles of the media business. They have historically been able to do selective well priced acquisitions both in their core broadcasting division and their growing digital and publishing businesses while successfully managing a large level of debt.

Growth Opportunities/Company Breakdown:

Recent results were rough on the top and bottom line as the company anniversaried tough comps post last year's election supported results, the inclusion of hurricane related weakness and the elimination of four loss making magazines that were shut in Q2 2017. Management talked about the election providing approximately \$1.3 million more to the company's results last Q3, and mentioned that the hurricanes in both Texas and Florida impacted results by approximately -\$350k. Station KLTN in Dallas was also singled out as a negative year over year distraction. It is a station that fell out of top status in that market a couple of years ago. They replaced the management there and have been working on the ratings, just recently moving back to number two in their key demographic. Although this improvement will help going forward, it is recent and is still hurting comps.

In total, the most recent quarter's revenue decreased over 8% and operating income decreased over 43% showing negative operating leverage. Adjusted EBITDA for the most recent quarter was down 24% as they saw topline pressure across their broadcast, digital media and publishing divisions. Publishing revenue in particular can be very lumpy, and absence of any large hits in the quarter, topline publishing revenue dropped 20% (simply hurting what was already a difficult year over year comp due to election spending the previous year).



What the EBITDA and FCF chart above highlights is what this management team has been able to do with the businesses every year. An incredibly consistent \$50 million plus Adjusted EBITDA and a slightly increasing Adjusted Free Cash Flow to the \$28 million level last

year not only strongly supports their debt level, it helps investors who are able to step back from a "noisy quarter" to see the business value over the years. This is not a high revenue growth or margin leverage story, it's a levered stock with incredible historical operating consistency.

Salem's broadcasting group includes 118 stations scattered across the entire county, with 73 of them in the top 25 radio markets. The radio station business stopped being a traditional growth business a long time ago, yet growth in GDP mixed with a reliable way for advertisers to reach a mass audience make it a profitable one still. As mentioned previously, 30%+ of company revenue comes from highly recurring programming revenue (it was noted as being 43% of a recent quarter's broadcasting results), where the programming is essentially locked-in, with popular broadcasters paying SALM for rights to specific time slots. When successful, they tend to stay in those slots and are willing to pay 2.5-5% rate increases each year to stay established and in a given time period. This programming time has higher margins than traditional spot advertising and has renewal rates exceeding 95% per year. Management talked about anticipated block-programming rate increases being around +3% on average for the upcoming year.

The Salem Radio Network consists of over 2,900 affiliates and includes programming from Hugh Hewitt, Eric Metaxas, Michael Medved and Mike Gallagher. Recent results of this piece of business puts it at the approximately \$18 million/year run rate (which is not a massive grower for their business in total, yet this piece was up 8% this past quarter and is really promising in a very mature industry).

Salem's Digital Media division has grown from about \$30 million in revenue in 2013 to over \$46 million run rate recently. This group consists of a number of websites and apps focused on both the Christian and conservative demographics and includes sites such as Crosswalk.com, Christianity.com, GodTube, Townhall.com, RedState, Hot Air, ChristianJobs.com and ChurchStaffing.com. Some of their apps include Daily Bible, One Place, Daily Devotion and Bible Study Tools. Growth in this business has been about 10%/year both

on the topline and in operating income (past 5 years). One thing that has changed fairly recently in this piece of business is that the company has been seeing increasing competition for direct advertisers from programmatic advertising platforms and from Facebook. They generated more page views and ad impressions across their platform, but had lower average rates here as more of them moved from being direct business to being programmatic business. During Q2 2017, traffic and revenue for their sites generated by Facebook was down -18.6% year over year. This trend isn't new to them, with Q3 2016 Facebook traffic being down -46% year over year (noted as being 9% of their total traffic at that point).

The Publishing piece of their business is roughly \$24-\$26 million/year and is dependent among other things on the election cycle, with conservative focused books doing well in those years. The division includes traditional book publishing businesses Regnery Publishing, Regnery Faith and Regnery History and also includes the self-publishing businesses Mill City Press and Xulon Press. They mention having more than 75 books on the NY Times Best Seller List and publish over 2 million books/year. Although meaningful to them, the nature of this business will tie it to election cycles with Presidential years standing out and mid-term election years also doing well. The management mentioned on the last quarter call that they are optimistic about the upcoming Q4 publishing releases, with three important titles coming. In addition, they have been focusing on expanding beyond political publishing into Christian titles. Next year will be their first full year with a slate of Christian titles. Both bode well for future publishing results in the near-term.

On balance, an investor can think of Salem as a broadcasting/radio business with a highly recurring and profitable revenue stream at \$202 million in revenue in 2016, a digital business that grew from \$27 million in 2012 to over \$46 million in 2016, and a publishing business that has a strong niche and has grown from \$13 million in 2012 to over \$25 million in 2016.

Salem is also an opportunistic acquirer and has been very active in the life of the company bringing in new businesses and folding them in to their corporate

umbrella. A few years back, Disney was selling off their radio station properties, and Salem picked up twelve stations at prices they were very happy with. Radio Station acquisitions often require a reformatting process, which means they may lose money for a while post the change in format. These changes initially hit this acquired portfolio, but the company continues to press profitability on this asset. More recent acquisitions include an AM radio station buy in Bethesda Maryland for \$1.5 million in cash, the acquisition of the Intelligence Report newsletter for deferred subscription liabilities, another FM translator for \$40k cash and TradersCrux.com website for \$.3 million. One thing they have been trying to take full advantage of is an FCC policy that allows them to buy translators and move them into major markets on very favorable terms (they've done over 30 now). Another focus has been mobile app acquisitions-they've talked about these specifically paying for themselves within a two-year time frame.

For Salem's broadcasting business, the competitive environment hasn't changed much over the years. The radio business is established and fairly stable. In terms of guidance, management policy is to only guide to the upcoming quarter. Recent guidance includes guidance of topline declines of between 4-6%, with the added color that excluding the impact of political revenue and the eliminated four loss-making magazines, revenue guidance would be a decline of 1-3%. Operating expense guidance is a range of flat to -3%. Given that the publishing slate is expected to be strong in Q4, their weaker Dallas station is showing real improvement, and the negative Facebook related digital business comps are becoming less and less meaningful, that guidance should be solid and potentially conservative.

Ownership Profile:

The ownership list of Salem Communications is very concentrated and worth knowing. The two founders, Edward Atsinger III (CEO) and Stuart Epperson (Chairman) own 21.4% and 17.8% respectively. Large current institutional holders include Gamco at 8.4%, Dimensional Fund Advisors at 5.5%, Blackrock at 4.3%, Teton Advisors at 3%, and Vanguard at 2.1%.

Institutions own 41.8% of the stock or 70.7% of the float, with insiders owning 40.9% in total.

Recent institutional moves include a smaller trim by Gamco last quarter and a decent sized add by Vanguard. Mr. Atsinger's most recent moves included a purchase of 33,066 shares at \$6.80 and another one earlier in the year of 96,102 shares at \$7.05. With 39.2% of the stock still in the hands of the original two founders, long-term interests are definitely biased in favor of the shareholders. Short interest exposure is 156k shares or roughly 1.3% of float—almost nonexistent and not a major factor.

Risk Profile:

Risks associated with an investment in Salem Communications include revenue performance linked to both general economic growth and the election cycle. Management comments from the Q4 2016 call put this in to perspective. They highlighted that during the last Presidential election in 2012, political spending was \$5.5 million, and in 2016 it was \$4.6 million (Trump spent less than his predecessors, with most of the political spending on SALM's platforms coming before Trump was chosen as the Republican candidate). The year prior to the Trump election netted \$1.6 million, with the prior mid-term election bringing in \$3.2 million. In the grand scheme of things, these numbers are not huge in terms of total SALM revenue, and yet this is very profitable revenue and it helps with better spot rates.

The publishing business in particular can be very lumpy, and recent results in their digital business have been pressured by internal changes in Facebook's advertising and from programmatic advertising platforms that are likely to continue. The company sometimes guarantees publishing royalties and inventory, and historically was burned by this practice. They need to be protective of how much they guarantee authors, and yet need to continue to balance this with the desire to add strong authors to their platform.

Another risk specific to Salem is their practice of self-insuring their health care costs. In Q3 of 2016, they were hit particularly hard with a number of high level

claims that popped their healthcare costs in the quarter by 52% for the quarter. An internal study showed that they had saved approximately \$5 million by choosing to go the self-insured route since they made that decision, and yet in any given quarter this may arise again. Short-term it can create noise, but long-term it is likely a smart decision. Another risk is Salem's absolute leverage, and although they just refinanced this through 2024, they will need to stay smart with their debt leverage ratios and continue to slowly and surely pay down debt. A general risk in SALM is the liquidity of small capitalization stocks, where limited liquidity and float can work both for and against you—position sizing and diversification are key here.

Valuation:

With a total enterprise value of \$374 million, \$262 million in long-term debt and a \$118 million market cap, consistent yearly EBITDA and cash results will eventually accrue to shareholders. The management has been very consistent with yearly debt paydowns, and the recent refinancing gives them flexibility through 2024 to not worry about refinancing risk in a potentially increasing interest rate environment. A \$.28 dividend isn't really a true dividend, but is a return of capital to shareholders and helps for long-term returns to the shareholders.

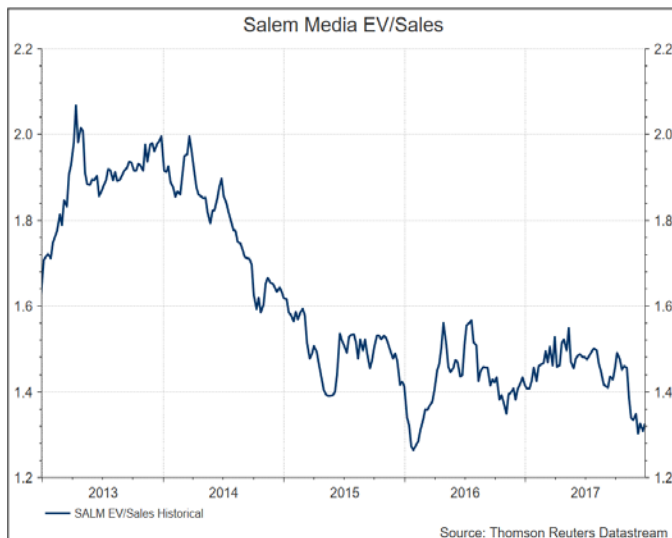
SALM Comps				Dividend
	PE	P/FCF	FCF Yield	Yield
Salem Media Group	10.1	4.1	24.4	5.8
Saga Communications	18.2	12	8.4	3
Beasley Broadcasting	14.3	20.7	4.8	1.3
Entravision	78.6	2.2	45.5	2.7
Gray	14.5	6.5	15.5	na
EW Scripps	30	16.6	6	na
Entercom	12.8	13.6	7.4	3.3

The above chart gives you a feel for where other radio broadcasters/media companies are trading at right now valuation-wise. Salem's traditional FCF yield, PE, P/FCF, and Dividend Yield all stand out favorably right now vs. the comps.

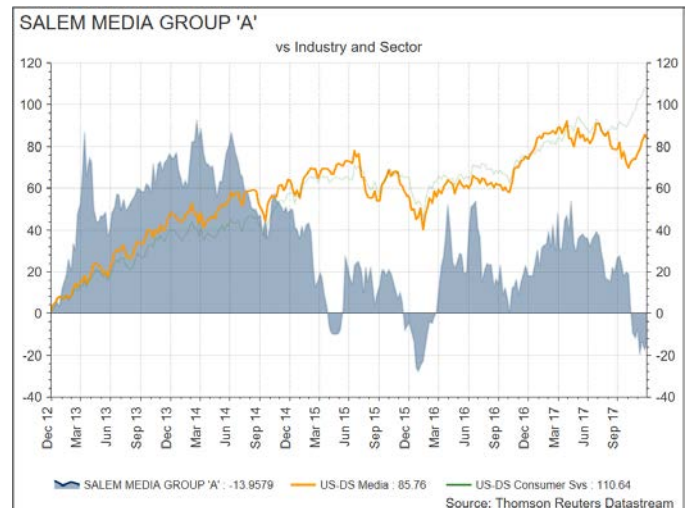
SALM Comps		EV/	1 Yr EV/	2 Yr EV/	Net Debt/
	Mkt Cap	TTM EBITDA	EBITDA	EBITDA	EBITDA
Salem Media Group	118	9.4	8.6	7.7	5.6
Saga Communications	239	7.6	nf	nf	nf
Beasley Broadcasting	390	11.7	nf	nf	4.3
Entravision	657	13.5	16.3	13.2	4.2
Gray	1500	8.8	10.7	8.1	5.2
EW Scripps	1280	12.5	16.6	7.5	1.8
Entercom	1600	10.2	20.8	17.2	5

Other valuation measures also look very favorable for Salem at the current trading range for the stock. EV/TTM EBITDA and a look at EV vs. future estimated EBITDA levels all look positive vs. the group. The net debt to reported EBITDA level is high vs. the comps. Although it is high on an absolute and relative basis, Salem has a long history of successfully managing this debt level and slowly paying down debt.

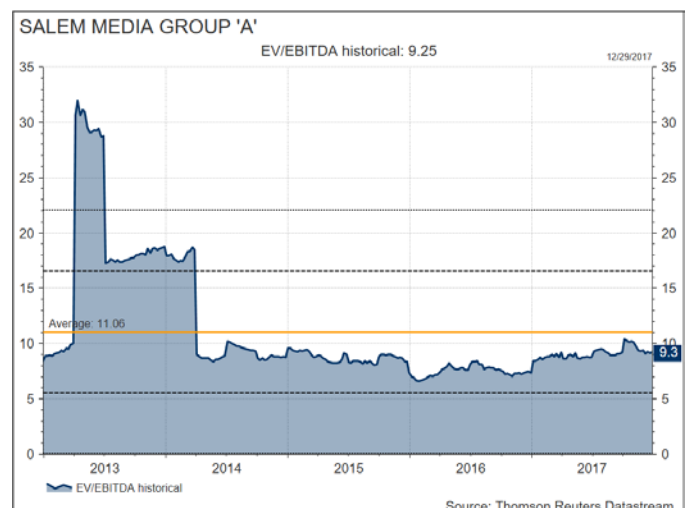
The following EV/Sales chart shows SALM's historical trading relationship on this metric since the end of 2012 to simply give another look at where SALM is trading in here. Although the ratio broke the 1.3 level for a small amount of time in early 2016, it historically has traded above the 1.4 level. The recent moves post a tough quarter give investors a potential opportunity to add this name at historical low trading ranges vs. historical levels. This trading level is an opportunity in valuation that isn't seen very often on Salem's stock. The fact that we are at the point of the year where tax-loss selling makes sense for prior holders may also be a part of the reason for the stock's recent weakness.



The below chart isn't necessarily a valuation chart, but shows how Salem's stock has performed vs. the media group and the consumer services sector over time. The volatility that comes in from time to time is apparent, and although those levels can seem to be dramatic moves this stock hasn't historically stayed down for long.



A look at SALM's traditional EV/reported EBITDA levels shows a stock with a fairly consistent valuation on this metric for a large number of years. Recent lower quarterly EBITDA results means this metric has moved up a bit, but has been pretty constant as both a measure of the firm's long-term performance and the stability of their EBITDA stream.



www.salemmedia.com Company webpage/more information on the company/historical financials/links to IR/etc.

Historical Income Statement:

SALM Income Statement (in millions)										
	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Net digital media revenue	46.9	45.9	11.28	11.31	12	12.72	46.8	10.69	10.87	10.45
Net publishing revenue	26.8	23.8	4.82	6.76	8.22	5.73	25.5	6.49	6	6.56
Net broadcast revenue	192.9	196.1	48.5	49.7	51.1	52.3	202	47.8	49.3	48.4
Total Revenue	266.5	265.8	64.6	67.8	71.3	70.7	274.3	65	66.1	65.4
(% sales growth year over year)	3.2%	-0.3%	4.4%	0.7%	5.6%	2.2%	12.5%	0.6%	-2.5%	-8.2%
Other internet operating expenses	36.1	35.9	9.2	8.8	9.2	9.5	36.2	8.7	8.4	8.2
Publishing expenses	26.1	24.7	5.0	7.0	8.0	6.2	26.2	6.3	5.7	6.7
Broadcast operating expenses	138.2	140.1	36.0	35.7	37.4	36.8	146.2	35.8	35.9	37.0
Other corporate expenses	16.1	14.6	4.1	3.5	4.1	3.0	14.6	4.2	3.8	4.0
Depreciation and Amortization	18.8	17.7	4.1	4.2	4.3	4.7	17.3	4.1	4.3	4.2
Stock based comp	1.0	0.5	0.1	0.1	0.1	0.1	0.4	1.0	0.0	0.3
Loss on sale/disposal of assets	0.3	0.2	0.2	-1.7	-0.5	0.1	-1.9	0.0	-0.5	0.1
Total Operating Expense	238.3	231.4	58.5	58.08	62.5	67.2	246.2	60.2	60.2	60.4
EBIT (Operating Income)	28.2	34.4	6.1	9.72	8.8	3.5	28.1	4.8	5.9	5
Interest Expense	-16	-15.4	-3.8	-3.7	-3.7	-3.7	-14.9	-3.4	-3.9	-4.8
Pretax Income	10.2	17.8	0.52	5.55	5.96	1.42	13.4	1.71	1.96	0.12
Income Taxes	4.8	6.7	0.17	2.19	3.76	-1.55	4.6	0.65	0.69	0.17
Net Income	5.5	11.2	0.35	3.36	2.19	2.97	8.9	1.06	1.27	-0.05
EPS (diluted) per share	0.21	0.43	0.01	0.13	0.08	0.11	0.34	0.04	0.05	0.00
Normalized EBITDA	47.8	51.4	10.4	12.9	12.7	15.3	51.2	9.0	12.4	9.3

A number of things stick out when looking at Salem's historical income statement. Total revenue has grown slightly over the most recent years, with political cycle help coming through in the 2016 election cycle. Although Q3's topline results (down -8%) were an eyesore compared to the prior-year's quarterly results (which included Presidential election spending), they came in near the previous year's more typical Q3 results. Normalized EBITDA levels at \$47.8 million, \$51.4 million and \$51.2 million in the past three years show some of the consistency and reliability of SALM's underlying businesses. A recent IR deck highlights yearly adjusted free cash flow in 2013, 2014, 2015 and 2016 of \$25, \$26, \$27, and \$28 million that is very supportive of the management team's continued focus on debt paydown and the addition of small, well-priced tuck-in types of acquisitions to their business mix.

Historical Balance Sheet:

SALM Balance Sheet (in millions)										
	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Assets										
Cash & Short Term Investments	0.00	0.10	0.10	0.00	0.10	0.10	0.10	0.10	0.00	0.00
AR-Trade, Net	34.80	37.20	31.80	33.10	36.40	37.30	37.30	34.00	33.60	35.90
Prepaid Expenses	5.60	6.30	6.10	6.30	7.00	6.30	6.30	6.10	7.10	7.30
Other Current Assets	9.90	11.50	11.50	10.80	10.80	10.40	10.40	1.00	1.00	0.00
Total Current Assets	54.40	58.00	52.90	52.00	56.10	55.50	55.50	42.90	43.50	45.00
Net Property, Plant and Equipment	99.20	105.50	105.20	104.60	103.30	102.80	102.80	102.60	101.60	102.20
Goodwill, net	24.70	24.60	24.80	24.80	25.70	25.60	25.60	25.60	25.60	26.40
Intangibles, net	399.00	405.30	407.70	407.60	410.60	403.30	403.30	402.30	401.20	403.30
Other Long-term assets	5.70	2.70	3.00	3.20	3.30	3.00	3.00	5.00	5.70	6.60
Total Assets	583.20	596.20	593.70	592.30	599.10	590.30	590.30	578.50	577.80	583.60
Liabilities & SH Equity										
Accounts Payable	3.00	5.20	4.22	3.60	5.80	5.00	5.00	5.80	2.50	3.70
Accrued Expenses	21.50	22.30	20.60	19.00	22.10	23.90	23.90	21.80	22.60	28.80
Current Portion of LT Debt/Cap Leases	1.90	5.70	6.10	4.40	2.70	0.60	0.60	2.10	10.10	6.70
Other Current liabilities	13.40	11.60	11.30	10.80	10.90	9.70	9.70	9.60	9.30	11.00
Total Current Liabilities	39.80	44.80	42.20	37.90	41.50	39.10	39.10	39.40	44.60	50.20
Long-Term Debt	275.60	269.10	267.00	266.40	265.40	261.10	261.10	255.50	249.20	249.40
Deferred Income Tax	49.10	57.10	57.20	59.30	62.80	60.80	60.80	53.90	54.50	54.60
Other Liabilities, Total	14.70	15.40	16.90	17.90	17.00	15.40	15.40	15.10	14.90	16.10
Total Liabilities	379.20	386.30	383.30	381.40	386.70	376.40	376.40	363.90	363.10	370.40
Additional Paid In Capital	240.50	241.80	242.00	242.50	243.50	243.60	243.60	245.00	245.50	245.80
Treasury Stock-Common	-34.00	-34.00	-34.00	-34.00	-34.00	-34.00	-34.00	-34.00	-34.00	-34.00
Total Equity	204.00	209.80	210.40	210.90	212.40	213.80	213.80	214.70	214.70	213.20
Total Liabilities & SHEquity	583.20	596.20	593.70	592.30	599.10	590.30	590.30	578.50	577.80	583.60
Tangible Book Value-common	-219.60	-220.10	-222.10	-221.50	-223.90	-215.00	-215.00	-213.30	-212.20	-216.50

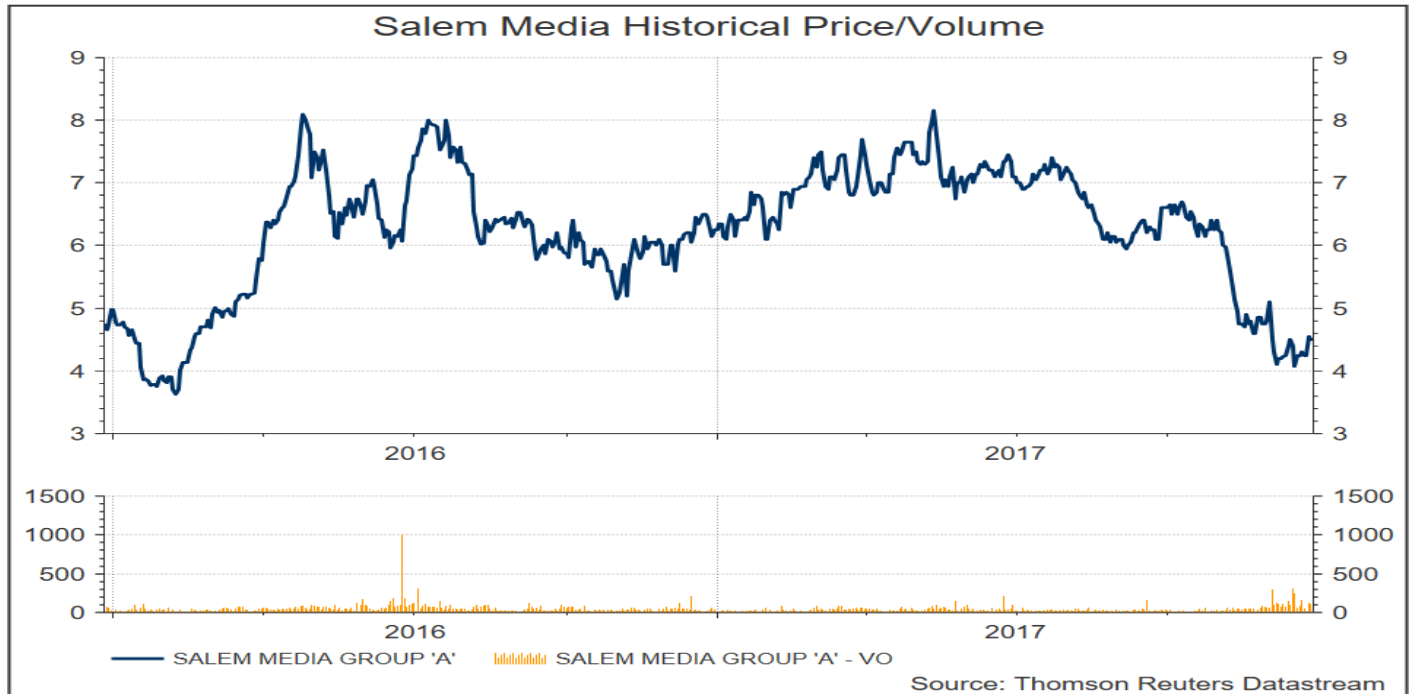
Salem's balance sheet quickly shows the levered nature of their business model. \$403 million in net intangibles, \$102 million in net PP&E and \$250 million in long-term debt are the major highlights here. With strong recent yearly adjusted EBITDA results that included a strong political spending environment, management was able to get their debt levels to the lowest they have been in years, coming in at just under 5 times. The recent quarterly results places that ratio back above those levels, but continued focus on paydown should drive that lower (management has mentioned wanting to get that to the 4.5 level or lower). The recent successful debt refinancing gives the management team a lot of time and flexibility until they have to even reconsider refinancing again (they pushed the maturity out to 2024). In a potentially upward interest rate environment, locking rates in at these levels made sense.

The recent refinancing was done in May of 2017, and they refinanced all of their debt with a \$255 million privately placed 7 year senior secured note due in 2024 and a \$30 million, 30 year asset backed revolver (neither require maintenance covenants). S&P upgraded their debt as part of this refinancing. As of September 30th, their noted leverage ratio was 5.31. Their debt used to be at roughly 5% and change, the vast majority is now locked for 7 years at 6.75%. Although they will be paying more short-term on this, they have protected the company against future interest rate increases through 2024 and have given themselves time to simply focus on running the business and slowly paying down the debt levels.

Historical Cash Flow Statement:

SALM Cash Flow Statement (in millions)										
	2014	2015	2016	2016	2016	2016	2016	2017	2017	2017
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
<u>Operating Activities</u>										
Net Income/Starting Line	5.50	11.20	0.35	3.36	2.19	2.97	8.90	1.06	1.27	-0.05
Depreciation, Depletion, & Amort.	18.80	17.80	4.14	4.17	4.32	4.65	17.30	4.12	4.25	4.22
Deferred Taxes & Inv. Tax Credit	4.40	6.30	0.12	2.06	3.51	-1.60	4.10	0.62	0.65	0.14
Non-cash items	10.30	2.70	2.35	-0.15	-0.51	5.90	7.60	1.69	2.88	1.40
Changes in Working Capital	2.97	-1.74	4.12	-0.79	-2.71	0.43	1.05	1.54	-1.51	2.88
Net Operating Cash Flow	41.90	36.10	11.08	8.64	6.79	12.36	38.90	9.04	7.54	8.59
<u>Investing Activities</u>										
Capital Expenditures	-10.07	-11.87	-2.63	-2.88	-2.22	-2.31	-10.03	-2.63	-2.19	-2.03
Other Investing Cash Flow Items	-11.66	-17.32	-3.05	1.43	-3.05	-0.79	-5.46	-0.50	0.33	-2.83
Net Investing Cash Flow	-21.73	-29.18	-5.68	-1.44	-5.27	-3.10	-15.49	-3.13	-1.86	-4.86
<u>Financing Activities</u>										
Financing Cash Flow Items	-0.31	-2.14	-2.60	-0.56	-0.36	-0.21	-3.73	-0.21	-7.18	-0.47
Cash dividends paid	-6.18	-6.61	0.00	-3.32	-1.68	-1.68	-6.68	-1.69	-1.70	-1.70
Issuance/Reduction of Stock, net	1.22	0.39	0.03	0.31	0.63	0.02	0.99	0.06	0.40	0.05
Issuance/Reduction of Debt, net	-14.95	1.48	-2.84	-3.67	-0.08	-7.34	-13.92	-4.11	2.74	-1.62
Net Financing Cash Flow	-20.22	-6.88	-5.41	-7.24	-1.48	-9.21	-23.34	-5.95	-5.75	-3.74
Net Change in Cash	-0.03	0.07	-0.01	-0.04	0.04	0.05	0.03	-0.05	-0.06	-0.02
Free Cash Flow	31.85	24.26	8.45	5.76	4.57	10.05	28.83	6.40	5.36	6.56

Salem Communication's cash flow statement shows the story of a levered radio/media company with high levels of depreciation that lead to strong net operating cash flow numbers on a consistent basis (\$42, \$36 and \$39 million the past three years). Capex has been steady in the \$10-\$12 million range, as have cash dividends in the \$6 million plus range. They were able to reduce debt levels by \$15 million in 2014 and \$14 million in 2016. Management has been consistent in their desire and shown the ability to lower total debt levels using operating cash flow over time. Further long-term reduction of debt levels will mean disproportionate gains to the equity piece of the enterprise value as the company slowly works on ways to grow topline and EBITDA over time.

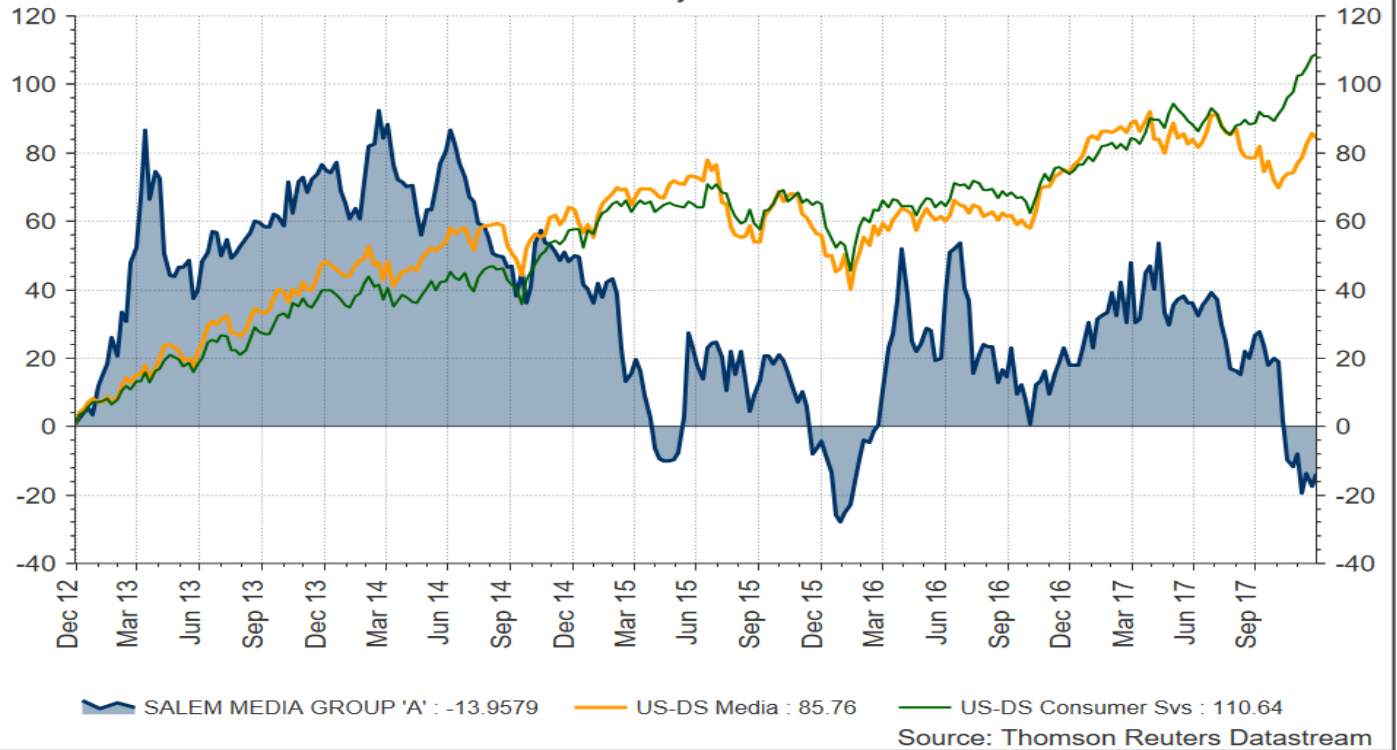


Recent topline and EBITDA results were an impetus for sellers to move out of the stock. Opportunity Equity Research believes that the weakness seen in recent quarters is temporary and somewhat based simply on tough comps post last year's election cycle juiced results. Looking at the chart below, SALM has historically had some moves down like this in the past—in 2015 it made a similar temporary move to these levels and quickly rebounded. In early 2016, it broke the \$4 level for a short period of time, only to rebound sharply on a percentage basis from those levels. A \$.28/year dividend that is counted as a return of capital because of NOL status also makes this stock even more interesting post the recent sell-off. O.E.R. believes investors that can get a position post the recent negative volatility may see handsome returns.



SALEM MEDIA GROUP 'A'

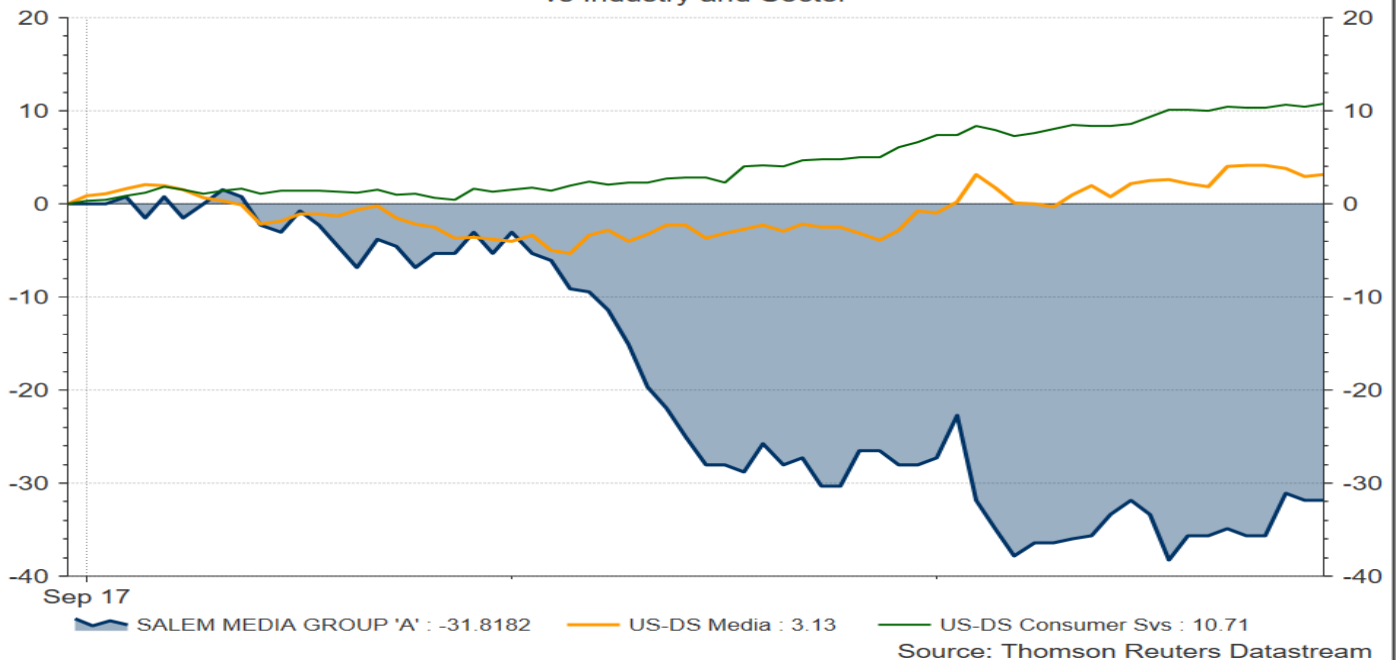
vs Industry and Sector



Both the above and below charts give investors a quick look at SALM historical performance vs. the Media Industry and the overall Consumer Services space. The above chart highlights the volatility the stock sees from time to time, followed by periods of consistency. The below chart shows how dramatic the recent move is and points to the potential buying opportunity as sellers move out post a tough quarter print and potential tax-loss selling.

SALEM MEDIA GROUP 'A'

vs Industry and Sector



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