CRITICARE SYSTEMS INC /DE/
Form 10-Q
February 05, 2007

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 December 31, 2006

OR

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

For the transition period from ____________ to ____________

Commission file number 1-31943

CRITICARE SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	39-1501563 (IRS Employer Identification No.)
20925 Crossroads Circle, Suite 100, Waukesha, Wisconsin (Address of principal executive offices)	53186 (Zip Code)

Registrant's telephone number including area code: (262) 798-8282

N/A
Former name, former address and former fiscal year, if changed since last report.

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

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

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

Number of shares outstanding of each class of the registrant's classes of common stock as of December 31, 2006: Voting Common Stock, 12,298,073 shares.

CRITICARE SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND JUNE 30, 2006

(UNAUDITED)

ASSETS	December 31, 2006	June 30, 2006
CURRENT ASSETS:		
Cash and cash equivalents	$ 3,947,297	$ 3,793,781
Accounts receivable, less allowance for doubtful accounts of $698,372 and $829,700, respectively	6,161,894	6,187,351
Other receivables	420,843	591,008
Short-term note receivable	50,000	50,000
Inventories	8,077,732	9,464,037
Prepaid expenses	119,288	227,606
Total current assets	18,777,054	20,313,783
Property, plant and equipment - net	2,401,237	2,452,314
License rights and patents - net	59,480	62,981
Long-term note receivable	100,000	150,000
Total other assets	159,480	212,981
TOTAL ASSETS	$ 21,337,771	$ 22,979,078
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 3,148,887	$ 5,408,746
Accrued liabilities:		
Compensation and commissions	937,699	914,889
Product warranties	388,000	425,000
Obligations under capital lease	71,114	68,205
Other	112,774	174,667
Total current liabilities	4,658,474	6,991,507
LONG-TERM LIABILITIES:		
Obligations under capital lease	97,526	133,826
Other long-term obligations	—	659
Total long-term liabilities	97,526	134,485
TOTAL LIABILITIES	4,756,000	7,125,992
STOCKHOLDERS' EQUITY:		
Preferred stock - $.04 par value, 500,000 shares authorized no shares issued or outstanding	—	—
Common stock - $.04 par value, 15,000,000 shares authorized, 12,399,631 and 12,398,131 shares issued, and 12,298,073 and 12,291,454 shares outstanding, respectively	495,985	495,925

Additional paid-in capital	26,223,139	26,156,864
Common stock held in treasury at cost (101,558 and 106,677 shares, respectively)	(366,278)	(375,813)
Retained earnings (accumulated deficit)	(9,753,186)	(10,436,794)
Other comprehensive income (loss)	(17,889)	12,904
Total stockholders' equity	16,581,771	15,853,086
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 21,337,771	$ 22,979,078

See notes to consolidated financial statements.

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CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF INCOME
SIX MONTHS ENDED DECEMBER 31, 2006 AND 2005

(UNAUDITED)

	2006	2005			
NET SALES	$ 16,669,334	$ 16,443,126			
COST OF GOODS SOLD	10,132,140	9,931,378			
GROSS PROFIT	6,537,194	6,511,748			
OPERATING EXPENSES:					
Sales and marketing	2,813,618	3,292,693			
Research, development and engineering	1,199,694	1,299,666			
Administrative	1,882,345	1,613,900			
Total	5,895,657	6,206,259			
INCOME FROM OPERATIONS	641,537	305,489			
OTHER INCOME (EXPENSE):					
Interest expense	(7,889)	(10,565)			
Interest income	62,661	41,974			
Other (expense) income	(12,700)	407,417			
Total	42,072	438,826			
INCOME BEFORE INCOME TAXES	683,609	744,315			
INCOME TAX PROVISION	—	—			
NET INCOME	$ 683,609	$ 744,315			
Weighted average basic common shares outstanding	42,623,395		42,623,395	53,654,681	53,654,681
Weighted average diluted common shares outstanding	43,721,263		42,623,395	54,975,235	54,975,235

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	September 30, 2006		
	Before Restatement	**Adjustments**	**As Restated**
Cash flows from operating activities:			
Net income	$ 6,821	$ 103	$ 6,924
Adjustments to reconcile net income to net cash provided by operating activities:			
Write-off of debt issue costs	2,284		2,284
Depreciation	13,147		13,147
Amortization of intangible assets and debt issurance costs	415		415
Provision for doubtful accounts	2,461		2,461
Change in the fair value of derivative instruments	(118)	(496)	(614)
Deferred income taxes	9,046	393	9,439
Non-cash stock compensation	10,765		10,765
Net gain on disposition of fixed assets	99		99
Gain on transfer of assets to unconsolidated affiliate	(2,548)		(2,548)
Equity loss on investment in unconsolidated affiliate	3,528		3,528
Changes in assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(5,531)		(5,531)
Prepaid expenses and other current assets	(1,464)		(1,464)
Accounts payable and accrued expenses	3,020		3,020
Other assets	2,223		2,223
Other liabilities	97		97
Net cash provided by operating activities	44,245		44,245
Cash flows from investing activities:			
Acquisitions, including investment in affiliate	(2,733)		(2,733)
Purchase of intangible assets	(9,152)		(9,152)
Escrow deposits on pending acquisitions	1,907		1,907
Capital expenditures	(8,165)		(8,165)
Other	192		192
Net cash used in investing activities	(17,951)		(17,951)
Cash flows from financing activities:			
Proceeds from bank credit facility	814,750		814,750
Repayments of borrowings from bank credit facility	(615,875)		(615,875)
Payments for debt issuance costs	(1,255)		(1,255)
Proceeds from issuance of common stock	1,654		1,654
Payment for repurchase of common stock	(223,995)		(223,995)
Net cash used in financing activities	(24,721)		(24,721)
Increase in cash and cash equivalents	1,573		1,573
Cash and cash equivalents at beginning of period	5,121		5,121

Cash and cash equivalents at end of period	$ 6,694	$ 6,694

The restatement also affects the amounts disclosed in Notes 7 and 8 to the accompanying unaudited condensed consolidated financial statements.

The Company made an immaterial correction to the accompanying December 31, 2006 balance sheet related to the above described restatement issue by reducing AOCI and decreasing the accumulated deficit by $0.4 million.

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3. Stock Based Compensation

For the three and nine months ended September 30, 2007, the Company recognized approximately $2.7 million and $7.0 million, respectively, in non-cash stock-based compensation expense.

The Board of Directors approved an amendment to the Company s 2004 Equity Incentive Plan, on April 13, 2007, which was subsequently approved by the Company s stockholders as well. The amendment increased the number of shares available to be issued under the plan from 2,975,000 to 3,665,000, and increased the number of shares that may be issued as restricted or deferred shares from 925,000 to 1,795,000.

During the nine months ended September 30, 2007, the Company reclassified $9.5 million from Treasury Stock to Additional Paid In Capital related to the issuance of 430,000 shares of restricted common stock.

4. Acquisitions and Dispositions

Pending Acquisitions

The Company did not complete any station acquisitions during the three and nine months ended September 30, 2007.

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5. Investment in Affiliate

On October 31, 2005, the Company announced that, together with Bain Capital Partners, The Blackstone Group and Thomas H. Lee Partners, it had formed a new private partnership, Cumulus Media Partners, LLC (CMP). CMP is a private partnership created by the Company and the equity partners to acquire the radio broadcasting business of Susquehanna Pfaltzgraff Co. Each of the Company and the equity partners holds a 25% equity ownership in CMP. Under the terms of the partnership arrangement, if certain performance targets are met, the Company s participation in the distribution of assets from CMP may be increased to up to 40%, with the respective participations in such distributions by each equity partner reduced to as low as 20%.

On May 5, 2006, the Company announced that the acquisition of the radio broadcasting business of Susquehanna Pfaltzgraff Co. by CMP was completed at a purchase price of approximately $1.2 billion. Susquehanna s radio broadcasting business consisted of 33 radio stations in 8 markets: San Francisco, Dallas, Houston, Atlanta, Cincinnati, Kansas City, Indianapolis and York, Pennsylvania.

In connection with the formation of CMP, the Company contributed four radio stations (including related licenses and assets) in the Houston, Texas and Kansas City, Missouri markets and approximately $6.2 million in cash in exchange for its membership interests in CMP. The Company recognized a gain of $2.5 million from the transfer of assets to CMP. In addition, upon consummation of the acquisition, the Company received a payment of approximately $3.5 million as consideration for advisory services provided in connection with the acquisition. The payment was recorded by the Company as a reduction in Cumulus s investment in CMP.

The Company s investment in CMP is accounted for under the equity method. For the three months ended September 30, 2007, the Company recorded approximately $0.8 million as equity in loss of affiliate and for the nine months ended September 30, 2007 the Company recorded $2.4 million as equity in loss from affiliate. These amounts are presented as part of non-operating income (loss) on the accompanying condensed consolidated statement of operations. For the three and nine months ended September 30, 2007, the affiliate generated revenues of $62.6 million and $174.6 million, operating expense of $35.4 million and $100.3 million and net loss of $3.2 million and $8.1 million, respectively. For the period May through September 2006, during which time the Company had an equity investment in CMP, the affiliate generated revenues of $104.0 million, station operating expense of $58.6 million and a net loss of $14.1 million.

6. Long-Term Debt

The Company s long-term debt consisted of the following at September 30, 2007 and December 31, 2006 (dollars in thousands):

	September 30, 2007	December 31, 2006
Term loan and revolving credit facilities	$738,150	$751,250
Less: Current portion of long-term debt	(7,500)	(7,500)
	$730,650	$743,750

2007 Refinancing

On June 11, 2007, the Company entered into an amendment to its existing credit agreement, dated June 7, 2006, by and among the Company, Bank of America, N.A., as administrative agent, and the lenders party thereto. The credit agreement, as amended, is referred to herein as the Amended Credit Agreement.

The Amended Credit Agreement provides for a replacement term loan facility, in the original aggregate principal amount of $750.0 million, to replace the prior term loan facility, had an outstanding balance at the time of refinancing of approximately $713.9 million, and maintains the pre-existing $100.0 million revolving credit facility.

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The proceeds of the replacement term loan facility, fully funded on June 11, 2007, were used to repay the outstanding balances under the prior term loan facility and under the revolving credit facility.

The Company s obligations under the Amended Credit Agreement are collateralized by substantially all of its assets in which a security interest may lawfully be granted (including FCC licenses held by its subsidiaries), including, without limitation, intellectual property and all of the capital stock of the Company s direct and indirect domestic subsidiaries (except for Broadcast Software International, Inc.) and 65% of the capital stock of certain first-tier foreign subsidiaries. In addition, the Company s obligations under the Amended Credit Agreement are guaranteed by certain of its subsidiaries.

The Amended Credit Agreement contains terms and conditions customary for financing arrangements of this nature. The replacement term loan facility will mature on June 11, 2014 and will amortize in equal quarterly installments beginning on September 30, 2007, with 0.25% of the initial aggregate advances payable each quarter during the first six years of the term, and 23.5% due in each quarter during the seventh year. The revolving credit facility will mature on June 7, 2012 and, except at the option of the Company, the commitment will remain unchanged up to that date. Borrowings under the replacement term loan facility bear interest, at the Company s option, at a rate equal to LIBOR plus 1.75% or the Alternate Base Rate (defined as the higher of the Bank of America Prime Rate and the Federal Funds rate plus 0.50%) plus 0.75%. Borrowings under the revolving credit facility bear interest, at the Company s option, at a rate equal to LIBOR plus a margin ranging between 0.675% and 2.0% or the Alternate Base Rate plus a margin ranging between 0.0% and 1.0% (in either case dependent upon the Company s leverage ratio).

As of September 30, 2007, prior to the effect of the May 2005 Swap, the effective interest rate of the outstanding borrowings pursuant to the credit facility was approximately 7.11%. As of September 30, 2007, the effective interest rate inclusive of the May 2005 Swap is 6.520%.

Certain mandatory prepayments of the term loan facility will be required upon the occurrence of specified events, including upon the incurrence of certain additional indebtedness (other than under any incremental credit facilities under the Amended Credit Agreement) and upon the sale of certain assets.

The representations, covenants and events of default in the Amended Credit Agreement are customary for financing transactions of this nature. Events of default in the Amended Credit Agreement include, among others, (a) the failure to pay when due the obligations owing under the credit facilities; (b) the failure to perform (and not timely remedy, if applicable) certain covenants; (c) cross default and cross acceleration; (d) the occurrence of bankruptcy or insolvency events; (e) certain judgments against the Company or any of its subsidiaries; (f) the loss, revocation or suspension of, or any material impairment in the ability to use any of our material FCC licenses; (g) any representation or warranty made, or report, certificate or financial statement delivered, to the lenders subsequently proven to have been incorrect in any material respect; (h) the occurrence of a Change in Control (as defined in the Amended Credit Agreement); and (i) violation of certain financial covenants. Upon the occurrence of an event of default, the lenders may terminate the loan commitments, accelerate all loans and exercise any of their rights under the Amended Credit Agreement and the ancillary loan documents as a secured party. As of September 30, 2007, the Company was in compliance with all financial and non-financial covenants.

In connection with the retirement of the Company s pre-existing credit facilities, the Company recorded a loss on early extinguishment of debt of $1.0 million for 2007, which was comprised of previously deferred loan origination expenses. In connection with the 2007 refinancing, the Company deferred approximately $1.0 million of debt issuance costs, which will be amortized to interest expense over the life of the debt.

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7. Earnings Per Share

The following table sets forth the computation of basic and diluted income per share for the three and nine month periods ended September 30, 2007 and 2006 (in thousands, except per share data).

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006 (RESTATED)	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006 (RESTATED)
Numerator:				
Net (loss) income	$(70,530)	$ (669)	$ (69,805)	$ 6,924
Denominator:				
Denominator for basic income per common share:				
Weighted average common shares outstanding	43,260	42,623	43,181	53,655
Effect of dilutive securities:				
Options				1,137
Restricted shares				183
Shares applicable to diluted income per common share	43,260	42,623	43,181	54,975
Basic (loss) income per common share	$ (1.63)	$ (0.02)	$ (1.62)	$ 0.13
Diluted (loss) income per common share	$ (1.63)	$ (0.02)	$ (1.62)	$ 0.13

The Company has issued to directors, key executives and employees restricted stock and stock options to purchase shares of common stock as part of the Company s stock incentive plans. At September 30, 2007 and 2006, the following restricted stock and stock options to purchase the following classes of common stock were issued and outstanding:

	September 30, 2007	September 30, 2006
Restricted shares of Class A Common Stock	654,216	1,005,000
Options to purchase Class A Common Stock	7,220,758	8,868,354
Options to purchase Class C Common Stock	1,500,690	1,500,690

For the three and nine months ended September 30, 2007, 6,847,015 and 6,853,274 options were not included in the calculation of weighted average diluted common shares outstanding because the exercise price of the options exceeded the average share price for the period and their effect would be anti dilutive.

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8. Comprehensive Income

SFAS No. 130, *Reporting Comprehensive Income,* establishes standards for reporting comprehensive income. Comprehensive income includes net income as currently reported under accounting principles generally accepted in the United States of America, and also considers the effect of additional economic events that are not required to be reported in determining net income, but rather are reported as a separate component of stockholders equity. The Company reports changes in the fair value of derivatives qualifying as cash flow hedges as components of comprehensive income. The components of comprehensive income are as follows (dollars in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006 (RESTATED)	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006 (RESTATED)
Net (loss)/income	$(70,530)	$ (669)	$ (69,805)	$ 6,924
Change in the fair value of derivative instruments				(780)
Yield adjustment interest rate swap arrangement	(828)		(828)	
Comprehensive (loss)/income	$(71,358)	$ (669)	$ (70,633)	$ 6,144

9. Commitments and Contingencies

The Company s national advertising contract with Katz Media Group, Inc (Katz) contains termination provisions which, if exercised by the Company during the term of the contract, would obligate the Company to pay a termination fee to Katz, calculated based upon a formula set forth in the contract.

The radio broadcast industry s principal ratings service is Arbitron, which publishes periodic ratings surveys for domestic radio markets. The Company has a five-year agreement with Arbitron under which the Company receives programming ratings materials in a majority of its markets. The Company s remaining obligation under the agreement with Arbitron totals approximately $12.0 million as of September 30, 2007 and will be paid in accordance with the agreement through July 2009.

In December 2004, the Company purchased 240 perpetual licenses from iBiquity Digital Corporation, which will enable the Company to convert to and utilize HD Radio technology on 240 of the Company s stations. Under the terms of the agreement, the Company has committed to convert the 240 stations over a seven year period beginning in the second half of 2005. The conversion of stations to the HD Radio technology will require an investment in certain capital equipment over the next five years. Management estimates its investment will be approximately $0.1 million per station converted.

The Company has been subpoenaed by the Office of the Attorney General of the State of New York, as were some of the other radio broadcasting companies operating in the state of New York, in connection with the New York Attorney General s investigation of promotional practices related to record companies dealings with radio stations. We are cooperating with the Attorney General in this investigation.

In May 2007, the Company received a request for information and documents from the FCC related to the Company s sponsorship of identification policies and sponsorship identification practices at certain of its radio stations as requested by the FCC. The Company is cooperating with the FCC in this investigation and is in the process of producing documents and other information requested by the FCC. The Company has not yet determined what effect the inquiry will have, if any, on its financial position, results of operations or cash flows.

The Company is also a defendant from time to time in various other lawsuits, which are generally incidental to its business. The Company is vigorously contesting all such matters and believes that their ultimate resolution will not have a material adverse effect on its consolidated financial position, results of operations or cash flows.

The Company is aware of three purported class action lawsuits related to the merger filed against the Company, its Chief Executive Officer, each of its directors, and the Sponsor, two of which were filed in the Superior Court of Fulton County, Georgia and the third filed in the Chancery court for the state of Delaware, New Castle County. The complaints allege among other things, that the Merger is the product of an unfair process, that the consideration to

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be paid to the Company s stockholders in the Merger is inadequate, and that the defendants breached their fiduciary duties to the Company s stockholders. The complaints further allege that the Company and the Sponsor aided and abetted the actions of the Company s directors in breaching such fiduciary duties. The complaints seek, among other relief, an injunction preventing completion of the Merger. We do not believe that the outcome of these lawsuits will have a material impact on the Company s financial position or the results of its operations.

10. Impairment of Goodwill and Intangible Assets

During the quarter ended September 30, 2007, the Company conducted an impairment evaluation of goodwill and broadcast licenses, as required under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142).

Goodwill

SFAS No. 142 requires the Company to test goodwill for impairment on an annual basis and more frequently if events or circumstances indicate that the asset may be impaired. SFAS No. 142 requires that the Company determine the appropriate reporting unit and compare the fair value of the reporting unit with its carrying amount. If the fair value of any reporting unit is less than the carrying amount, an indication exists that the amount of goodwill attributed to the reporting unit may be impaired and the Company is required to perform a second step of the impairment test. In the second step, the Company compares the implied fair value of each reporting unit s goodwill, determined by allocating the reporting unit s fair value to all of its assets and liabilities, to the carrying amount of the reporting unit.

As of September 30, 2007, the fair value of reporting units was determined primarily by using a discounted cash flows approach. The fair values derived include assumptions that contain a variety of variables. These variables are based on industry data, historical experience and estimates of future performance and include, but are not limited to, revenue and expense growth rates for each radio market, revenue and expense growth rates for the Company s stations in each market, overall discount rates based on the Company s weighted average cost of capital and acquisition multiples. The assumptions used in estimating the fair values of goodwill are based on currently available data and management s best estimates and, accordingly, a change in market conditions or other factors could have a material effect on the estimated values.

As of September 30, 2007, the Company determined that the carrying value of certain reporting units exceeded their fair values. Accordingly, the Company recorded an impairment charge of $17.1 million as reflected in the consolidated statements of operations, to reduce the carrying value of goodwill.

Broadcast Licenses

SFAS No. 142 requires the Company to test FCC broadcast licenses for impairment on an annual basis and more frequently if events or circumstances indicate that the asset may be impaired. When performing the impairment evaluation of existing intangible assets with indefinite lives, the Company determines the appropriate reporting unit and then compares the carrying amount of each reporting unit s broadcast licenses with their fair value. Consistent with prior years, the Company determined that the appropriate reporting unit is a radio market for the purposes of the impairment evaluation associated with the above mentioned transaction.

As of September 30, 2007 the fair value of broadcast licenses was determined primarily by using a discounted cash flows approach. The fair values derived include assumptions that contain a variety of variables. These variables are based on available industry data, historical experience and estimates of future performance and include, but are not limited to, revenue and expense growth rates for each radio market, overall discount rates based on our weighted average cost of capital and acquisition multiples. The assumptions used in estimating the fair values of broadcast licenses are based on currently available data and management s best estimates and, accordingly, a change in market conditions or other factors could have a material effect on the estimated values.

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As of September 30, 2007 the Company determined that the carrying value of broadcast licenses in certain of its reporting units exceeded their fair value. Accordingly, the Company recorded an impairment charge of $64.3 million as reflected in the consolidated statements of operations, to reduce the carrying value of broadcast licenses.

The above described impairment charges recorded during the third quarter of 2007 were treated as a discrete item for the purposes of the income tax benefit calculation for the three and nine months ended September 30, 2007. The aggregate benefit recognized associated with the impairment charges discussed above was $21.2 million for the three and nine months ended September 30, 2007.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

2006 Restatement

In May 2005 we entered into a forward-starting LIBOR-based interest rate swap arrangement (the May 2005 Swap) to manage fluctuations in cash flows for certain of our debt instruments resulting from interest rate risk attributable to changes in the benchmark interest rate of LIBOR. Through fiscal year 2006, we accounted for the May 2005 Swap as a qualifying cash flow hedge of the future variable rate interest payments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, whereby changes in the fair value are reported as a component of the Company s accumulated other comprehensive income (AOCI), a portion of stockholders equity.

Subsequent to the filing of the Company s annual report on Form 10-K for the year ended December 31, 2006, management discovered that beginning June 15, 2006, in connection with the refinancing of the Company s debt, based on the interest rate elections made by the company at this time, the May 2005 Swap no longer qualified as a cash flow hedging instrument. Accordingly, the changes in its fair value should have been reflected in the statement of operations instead of AOCI. In addition, as of June 15, 2006, certain amounts included in AOCI should have been reversed and recognized in the statement of operations.

As a result of the of the corrections of the error discussed above, the Company s income before income tax benefit and equity loss of affiliate for the three and nine months ended September 30, 2006 decreased approximately $5.8 million and increased approximately $0.5 million, respectively, resulting primarily from the reclassification of a portion of AOCI to the statement of operations. Net income for the three and nine months ended September 30, 2006 decreased approximately $1.9 million and increased approximately $0.1 million, respectively.

The following table sets forth the effects of the errors in accounting for the May 2005 Swap, as more fully described in Note 2 in the condensed consolidated financial statements included in this report (dollars in thousands).

	As Previously Reported Three Months Ended September 30, 2006	**Adjustments**	**RESTATED Three Months Ended September 30, 2006**
Bank borrowings term loan and revolving credit facilities	$(14,717)	$	$ (14,717)
Bank borrowings yield adjustment interest rate swap arrangement	1,389		1,389
Bank borrowings yield adjustment for amount reclassified from other comprehensive income upon hedge accounting discontinuation		(6,087)	(6,087)
Bank borrowings yield adjustment for change in fair value of the interest rate swap agreement		270	270
Change in fair value of interest rate option agreement	(741)		(741)
Other interest expense	(408)		(408)
Interest income	239		239
Interest expense, net	$(14,238)	$(5,817)	$ (20,055)

	As Previously		**RESTATED**

	Reported Nine Months Ended September 30, 2006	**Adjustments**	**Nine Months Ended September 30, 2006**
Bank borrowings term loan and revolving credit facilities	$(32,768)	$	$ (32,768)
Bank borrowings yield adjustment interest rate swap arrangement	3,885		3,885
Bank borrowings yield adjustment for amount reclassified from other comprehensive income upon hedge accounting discontinuation		(530)	(530)
Bank borrowings yield adjustment for change in fair value of the interest rate swap agreement		1,026	1,026
Change in fair value of interest rate option agreement	796		796
Other interest expense	(2,119)		(2,119)
Interest income	542		542
Interest expense, net	$(29,664)	$ 496	$ (29,168)

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General

The following discussion of our condensed consolidated financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes thereto included elsewhere in this quarterly report. This discussion, as well as various other sections of this quarterly report, contains statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements relate to the intent, belief or current expectations of our officers primarily with respect to our future operating performance. Any such forward-looking statements are not guarantees of future performance and may involve risks and uncertainties. Actual results may differ from those in the forward-looking statements as a result of various factors, including but not limited to, the occurrence of any event, change or other circumstance that could give rise to the termination of the Merger Agreement described in Note 1 to the condensed consolidated financial statements included in this report; the outcome of any legal proceedings that have been or may be instituted against us related to the Merger Agreement; the inability to complete the Merger due to the failure to obtain stockholder or regulatory approval of the Merger; the failure to obtain the necessary financing arrangements set forth in the debt and equity commitment letters delivered pursuant to the Merger Agreement; risks that the proposed transaction disrupts current plans and operations and the potential difficulties in employee retention as a result of the Merger; and the ability to recognize the benefits of the Merger, as well as, risks and uncertainties relating to leverage, the need for additional funds, FCC and government approval of pending acquisitions, our inability to renew one or more of our broadcast licenses, changes in interest rates, consummation of our pending acquisitions, integration of acquisitions, our ability to eliminate certain costs, the management of rapid growth, the popularity of radio as a broadcasting and advertising medium, changing consumer tastes, the impact of general economic conditions in the United States or in specific markets in which we currently do business, industry conditions, including existing competition and future competitive technologies and cancellation, disruptions or postponements of advertising schedules in response to national or world events. Many of these risks and uncertainties are beyond our control. This discussion identifies important factors that could cause such differences. The unexpected occurrence of any such factors would significantly alter the results set forth in these statements.

Overview

The following discussion of our financial condition and results of operations includes the results of acquisitions and local marketing, management and consulting agreements. As of September 30, 2007, we owned and operated 313 stations in 60 U.S. markets and provided sales and marketing services under local marketing, management and consulting agreements (pending FCC approval of acquisition) to six stations in three U.S. markets. In addition, we, along with three private equity firms, formed Cumulus Media Partners, LLC (CMP), which acquired the radio broadcasting business of Susquehanna Pfaltzgraff Co. (Susquehanna) in May 2006. The acquisition included 33 radio stations in 8 markets.

As a result of our investment in CMP and the acquisition of Susquehanna s radio operations, we continue to be the second largest radio broadcasting company in the United States based on number of stations and believe that, based upon the stations we own or manage through CMP, we are the third largest radio broadcasting company based on net revenues. As of September 30, 2007 we, directly and through our investment in CMP, own or operate a total of 347 radio stations in 68 U.S. markets.

Advertising Revenue and Station Operating Income

Our primary source of revenue is the sale of advertising time on our radio stations. Our sales of advertising time are primarily affected by the demand for advertising time from local, regional and national advertisers and the advertising rates charged by our radio stations. Advertising demand and rates are based primarily on a station s ability to attract audiences in the demographic groups targeted by its advertisers, as measured principally by Arbitron on a periodic basis-generally one, two or four times per year. Because audience ratings in local markets are crucial to a station s financial success, we endeavor to develop strong listener loyalty. We believe that the diversification of formats on our stations helps to insulate them from the effects of changes in the musical tastes of the public with respect to any particular format.

The number of advertisements that can be broadcast without jeopardizing listening levels and the resulting ratings is limited in part by the format of a particular station. Our stations strive to maximize revenue by managing their on-air inventory of advertising time and adjusting prices based upon local market conditions. In the broadcasting industry, radio stations sometimes utilize trade or barter agreements that exchange advertising time for goods or services such as travel or lodging, instead of for cash.

Our advertising contracts are generally short-term. We generate most of our revenue from local advertising, which is sold primarily by a station s sales staff. During the nine months ended September 30, 2007 and 2006, approximately 87.9% and 89.0% of our revenues were from local advertising, respectively. We generate national advertising revenue with the assistance of an outside national representation firm. We have engaged Katz Media Group, Inc. (Katz) to represent the Company as our national advertising sales agent.

Our revenues vary throughout the year. As is typical in the radio broadcasting industry, we expect our first calendar quarter will produce the lowest revenues for the year.

Our operating results in any period may be affected by the incurrence of advertising and promotion expenses that typically do not have an effect on revenue generation until future periods, if at all. Our most significant station operating expenses are employee salaries and commissions, programming expenses, advertising and promotional expenditures, technical expenses, and general and administrative expenses. We strive to control these expenses by working closely with local station management. The performance of radio station groups, such as ours, is customarily measured by the ability to generate station operating income. See the definition of this non-GAAP measure, including a description of the reasons for its presentation, as well as a quantitative reconciliation to its most directly comparable financial measure calculated and presented in accordance with GAAP, below.

Results of Operations

Analysis of Condensed Consolidated Statements of Operations. The following analysis of selected data from our condensed consolidated statements of operations and other supplementary data should be referred to while reading the results of operations discussion that follows (dollars in thousands):

	For the Three Months Ended September 30, 2007	For the Three Months Ended September 30, 2006	Increas/(Decrease) 2007 vs. 2006	Percent Change 2007 vs. 2006
		As RESTATED		
STATEMENT OF OPERATIONS DATA:				
Net revenues	$ 84,183	$ 83,951	$ 232	0.3%
Station operating expenses excluding depreciation, amortization and LMA fees	52,241	51,877	364	0.7%
Depreciation and amortization	3,624	4,236	(612)	-14.4%
LMA fees	163	400	(237)	-59.3%
Corporate general and administrative expenses (including non-cash stock compensation expense)	6,981	7,077	(96)	-1.4%
Impairment of goodwill and intangible assets	81,335		81,335	100.0%
Costs associated with proposed merger	2,413		2,413	100.0%
Operating (loss) income	(62,574)	20,361	(80,522)	-395.5%
Interest (expense), net	(17,147)	(20,055)	(2,908)	-14.5%

Other income (expense), net	7	(117)	124	-106.0%
Income tax (expense) benefit	9,973	183	9,790	5349.7%
Equity in loss of affiliate	(789)	(1,041)	252	24.2%
Net (loss) income	$(70,530)	$ (669)	$ (69,861)	10442.6%
OTHER DATA:				
Station Operating Income (1)	$ 31,942	$ 32,074	$ (132)	-0.4%
Station Operating Income Margin (2)	37.9%	38.2%	**	**

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	For the Nine Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006	Increas/(Decrease) 2007 vs. 2006	Percent Change 2007 vs. 2006
		AS RESTATED		
STATEMENT OF OPERATIONS DATA:				
Net revenues	$243,922	$ 246,562	$ (2,640)	-1.1%
Station operating expenses excluding depreciation, amortization and LMA fees	157,469	160,608	(3,139)	-2.0%
Depreciation and amortization	11,184	13,562	(2,378)	-17.5%
Gain on assets transferred to affiliate		(2,548)	(2,548)	-100.0%
LMA fees	494	797	(303)	-38.0%
Corporate general and administrative expenses (including non-cash stock compensation expense)	19,761	22,845	(3,084)	-13.5%
Impairment of goodwill and intangible assets	81,335		81,335	100.0%
Costs associated with proposed merger	2,413		2,413	100.0%
Operating (loss) income	(28,734)	51,298	(80,032)	-156.0%
Interest expense, net	(42,148)	(29,168)	12,980	44.5%
Loss on early extinguishment of debt	(986)	(2,284)	1,298	56.8%
Other income (expense), net	(163)	45	(208)	-462.2%
Income tax (expense) benefit	4,573	(9,439)	(14,012)	148.5%
Equity in loss of affiliate	(2,347)	(3,528)	(1,181)	-33.5%
Net (loss) income	$ (69,805)	$ 6,924	$ (76,729)	-1108.2%
OTHER DATA:				
Station operating income (1)	$ 86,453	$ 85,954	$ 499	0.6%
Station operating income margin (2)	35.4%	34.9%	**	**
Cash flows related to:				
Operating activities	29,309	44,245	(14,836)	-33.8%
Investing activities	(4,903)	(17,951)	(13,048)	-72.7%
Financing activities	(14,349)	(24,721)	(10,372)	-42.0%
Capital expenditures	$ (3,714)	$ (8,165)	$ (4,451)	-54.5%

** Calculation is not meaningful.

(1) Station operating income consists of operating

income before depreciation and amortization, LMA fees, corporate general and administrative expenses (including non-cash stock compensation), gain on assets transferred to affiliate, impairment charge, and costs associated with proposed merger. Station operating income should not be considered in isolation or as a substitute for net income (loss), operating income, cash flows from operating activities or any other measure for determining our operating performance or liquidity that is calculated in accordance with GAAP. See management s explanation of this measure and the reasons for its use and presentation, along with a quantitative reconciliation of station operating income to its most directly comparable financial measure calculated and presented in accordance with GAAP, below.

(2) Station operating income margin is defined as station operating income as a percentage of net revenues.

Three Months Ended September 30, 2007 versus the Three Months Ended September 30, 2006.

Net Revenues. Net revenues increased $0.2 million, or 0.3%, to $84.2 million for the three months ended September 30, 2007 from $84.0 million for the three months ended September 30, 2006.

Station Operating Expenses, Excluding Depreciation, Amortization and LMA Fees. Station operating expenses excluding depreciation, amortization and LMA fees, increased $0.3 million, or 0.7%, to $52.2 million for the three months ended September 30, 2007 from $51.9 million for the three months ended September 30, 2006. This increase was due to general expense increases across our station platform.

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Depreciation and Amortization. Depreciation and amortization decreased $0.6 million, or 14.4%, to $3.6 million for the three months ended September 30, 2007 compared to $4.2 million for the three months ended September 30, 2006. This decrease was primarily attributable to previously recorded assets being fully depreciated combined with the contribution of certain assets to CMP in 2006.

LMA Fees. LMA fees totaled $0.2 million for the three months ended September 30, 2007, versus $0.4 million for the three months ended September 30, 2006. LMA fees in the current year were comprised primarily of fees associated with stations operated under LMAs in Vinton, Iowa, Ann Arbor, Michigan and Battle Creek, Michigan.

Corporate, General and Administrative Expenses. Corporate, general and administrative expenses decreased $0.1 million or 1.4% to $7.0 million for the three months ended September 30, 2007 as compared to $7.1 million for the three months ended September 30, 2006. This decrease was due primarily to the timing of certain expenses.

Impairment. An impairment charge of $81.3 million was recorded during the third quarter of 2007.

Costs Associated With Proposed Merger. Professional fees related to privatization totaled $2.4 million for the three months ended September 30, 2007. The fees included attorneys, banking, consulting and other sundry fees incurred in conjunction with the privatization, see Note 1 to the financial statements included in this quarterly report. Additional costs related to the privatization process will be incurred in the future.

Nonoperating Income (Expense). Interest expense, net of interest income, decreased by $2.9 million, or 14.5%, to $17.1 million for the three months ended September 30, 2007 compared to $20.0 million for the three months ended September 30, 2006. Interest associated with outstanding debt decreased by $1.5 million to $13.2 million as compared to $14.7 million in the prior year s period. This decrease was due to a lower average cost of bank debt and decreased levels of bank debt outstanding during the current quarter. The remainder of the decrease was primarily due to the change in the fair value and interest rate yield of certain derivative instruments. The following summary details the components of our interest expense, net of interest income (dollars in thousands):

		RESTATED (1)		
	For the Three Months Ended September 30, 2007	**For the Three Months Ended September 30, 2006**	**Increase/(decrease) 2007 vs 2006**	**Percent Change 2007 vs 2006**
Bank borrowings term loan and revolving credit facilities	(13,244)	$ (14,717)	$ (1,473)	-10.0%
Bank borrowings yield adjustment interest rate swap arrangement	2,380	1,389	991	71.3%
Bank borrowings one-time yield adjustment for amount reclassified from other comprehensive income upon hedge accounting discontinuation		(6,087)	6,087	100.0%
Bank borrowings yield adjustment for change in fair value of the interest rate swap agreement	(4,874)	270	(5,144)	-1905.2%
Change in fair value of interest rate option agreement	(1,350)	(741)	(609)	-82.2%
Other interest expense	(221)	(408)	(187)	-45.8%
Interest income	162	239	(77)	-32.2%
Interest expense, net	$(17,147)	$ (20,055)	$ (2,908)	14.5%

(1) See note 2 to the accompanying financial statements for further discussion of the restatement.

Income Taxes. Income tax benefit increased $9.8 million to $10.0 million for the three months ended September 30, 2007, compared to $0.2 million benefit for the three months ended September 30, 2006.

Station Operating Income. As a result of the factors described above, station operating income decreased $0.2 million, or 0.4%, to $31.9 million for the three months ended September 30, 2007, compared to $32.1 million for the three months ended September 30, 2006. Station operating income consists of operating income before depreciation and amortization, LMA fees, corporate general and administrative expenses (including non-cash stock compensation), impairment charge, and costs associated with proposed merger. Station operating income should not be considered in isolation or as a substitute for net income, operating income (loss), cash flows from operating activities or any other measure for determining our operating performance or liquidity that is calculated in accordance with GAAP. We exclude depreciation and amortization due to the insignificant investment in tangible assets required to operate our stations and the relatively insignificant amount of intangible assets subject to amortization. We exclude LMA fees from this measure, even though it requires a cash commitment, due to the insignificance and temporary nature of such fees. Corporate expenses, despite representing an additional significant cash commitment, are excluded in an effort to present the operating performance of our stations exclusive of the corporate resources employed. We believe this is important to our investors because it highlights the gross margin generated by our station portfolio. Finally, we exclude non-cash stock compensation and gain on assets transferred to affiliate from the measure as they do not represent cash activities related to the operation of the stations.

We believe that station operating income is the most frequently used financial measure in determining the market value of a radio station or group of stations. We have observed that station operating income is commonly employed by firms that provide appraisal services to the broadcasting industry in valuing radio stations. Further, in each of the more than 140 radio station acquisitions we have completed since our inception, we have used station operating income as our primary metric to evaluate and negotiate the purchase price to be paid. Given its relevance to the estimated value of a radio station, we believe, and our experience indicates, that investors consider the measure to be useful in order to determine the value of our portfolio of stations. We believe that station operating income is the most commonly used financial measure employed by the investment community to compare the performance of radio station operators. Finally, station operating income is the primary measure that our management uses to evaluate the performance and results of our stations. Our management uses the measure to assess the performance of our station managers and our Board of Directors uses it to determine the relative performance of our executive management. As a result, in disclosing station operating income, we are providing our investors with an analysis of our performance that is consistent with that which is utilized by our management and our Board.

Station operating income is not a recognized term under GAAP and does not purport to be an alternative to operating income from continuing operations as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Additionally, station operating income is not intended to be a measure of free cash flow available for dividends, reinvestment in our business or other Company discretionary use, as it does not consider certain cash requirements such as interest payments, tax payments and debt service requirements. Station operating income should be viewed as a supplement to, and not a substitute for, results of operations presented on the basis of GAAP. We compensate for the limitations of using station operating income by using it only to supplement our GAAP results to provide a more complete understanding of the factors and trends affecting our business other than GAAP results alone. Station operating income has its limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Moreover, because not all companies use identical calculations, these presentations of station operating income may not be comparable to other similarly titled measures of other companies.

Reconciliation of Non-GAAP Financial Measure. The following table reconciles station operating income to operating income as presented in the accompanying condensed consolidated statements of operations (the most directly comparable financial measure calculated and presented in accordance with GAAP) (dollars in thousands):

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	For the Three Months Ended September 30, 2007	For the Three Months Ended September 30, 2006
Operating (loss) income	$(62,574)	$ 20,361
Depreciation and amortization	3,624	4,236
LMA fees	163	400
Corporate general and administrative expenses	6,981	7,077
Impairment charge	81,335	
Costs associated with proposed merger	2,413	
Station operating income	$ 31,942	$ 32,074

Nine Months Ended September 30, 2007 versus the Nine Months Ended September 30, 2006.

Net Revenues. Net revenues for the nine months ended September 30, 2007 decreased $2.6 million to $243.9 million, a 1.1% decrease from the same period in 2006, primarily as a result of the contribution of the Company s Houston and Kansas City stations to our affiliate, CMP, partially offset by organic growth over the Company s existing station platform.

Station Operating Expenses, Excluding Depreciation, Amortization and LMA. Station operating expenses excluding depreciation, amortization and LMA fees decreased $3.1 million, or 2.0%, to $157.5 million for the nine months ended September 30, 2007 from $160.6 million for the nine months ended September 30, 2006. This decrease was primarily a result of the contribution of our Houston and Kansas City stations to CMP, as well as general expense decreases across our station platform.

Depreciation and Amortization. Depreciation and amortization decreased $2.4 million, or 17.5%, to $11.2 million for the nine months ended September 30, 2007 compared to $13.6 million for the nine months ended September 30, 2006. This decrease was primarily attributable to previously recorded assets being fully depreciated combined with the contribution of certain assets to CMP in 2006.

LMA Fees. LMA fees totaled $0.5 million for the nine months ended September 30, 2007, compared to $0.8 million for the nine months ended September 30, 2006. LMA fees in the current year were comprised primarily of fees associated with stations operated under LMAs in Vinton, Iowa, Ann Arbor, Michigan, and Battle Creek, Michigan

Corporate, General and Administrative Expenses. Corporate, general and administrative expenses decreased $3.1 million or 13.5% to $19.7 million for the nine months ended September 30, 2007 as compared to $22.8 million for the nine months ended September 30, 2006. This decrease was primarily attributable to a decrease in non-cash stock compensation costs of $3.7 million offset by an increase in other general expenses of $0.6 million due primarily to the timing of certain expenses.

Impairment. An impairment charge of $81.3 million was recorded during the third quarter of 2007.

Costs Associated With Proposed Merger. Professional fees related to privatization totaled $2.4 million for the three months ended September 30, 2007. The fees included attorneys, banking, consulting and other sundry fees incurred in conjunction with the privatization. Additional costs related to the privatization process will be incurred in the future.

Nonoperating Income (Expense). Interest expense, net of interest income, increased by $13.0 million, or 44.5%, to $42.1 million for the nine months ended September 30, 2007 compared to $29.1 million for the nine months ended September 30, 2006. Interest associated with outstanding debt increased by $8.0 million to $40.8 million as

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compared to $32.8 million in the prior year s period. This increase was due to a higher average cost of bank debt and increased levels of bank debt outstanding during the current year. The remainder of the increase was primarily due to the change in the fair value and interest rate yield of certain derivative instruments. The following summary details the components of our interest expense, net of interest income (dollars in thousands):

		RESTATED (1)		
	For the Nine Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006	Inccrease(Decrease) 2007 vs. 2006	Percent Change 2007 vs 2006
Bank borrowings term loan and revolving credit facilities	$(40,822)	$ (32,768)	$ 8,054	24.6%
Bank borrowings yield adjustment interest rate swap arrangement	5,180	3,885	1,295	33.3%
Bank borrowings one-time yield adjustment for amount reclassified from other comprehensive income upon hedge accounting discontinuation		(530)	530	100.0%
Bank borrowings yield adjustment for change in fair value of the interest rate swap agreement	(5,542)	1,026	(6,568)	-640.2%
Change in fair value of interest rate option agreement	(551)	796	(1,347)	-169.2%
Other interest expense	(765)	(2,119)	(1,354)	-63.9%
Interest income	352	542	(190)	-35.1%
Interest expense, net	$(42,148)	$ (29,168)	$ 12,980	44.5%

(1) See note 2 to the accompanying financial statements for further discussion of the restatement

Income Taxes. For the nine months ended September 30, 2007, the Company recorded an income tax benefit of $4.6 million, as compared to $9.4 million expense during the same period during 2006. Included in the year to date benefit is a third quarter income tax benefit of $21.2 million associated with the impairment charge discussed above.

Station Operating Income. As a result of the factors described above, station operating income increased $0.5 million, or 0.6%, to $86.5 million for the nine months ended September 30, 2007, compared to $86.0 million for the nine months ended September 30, 2007. Station operating income consists of operating income before depreciation and amortization, LMA fees, corporate general and administrative expenses (including non-cash stock compensation), gain on assets transferred to affiliate, impairment charge, and costs associated with proposed merger. Station operating income should not be considered in isolation or as a substitute for net income, operating income (loss), cash flows from operating activities or any other measure for determining our operating performance or liquidity that is calculated in accordance with GAAP. We exclude depreciation and amortization due to the insignificant investment in tangible assets required to operate our stations and the relatively insignificant amount of intangible assets subject to amortization. We exclude LMA fees from this measure, even though it requires a cash commitment, due to the insignificance and temporary nature of such fees. Corporate expenses, despite representing an additional significant cash commitment, are excluded in an effort to present the operating performance of our stations exclusive of the corporate resources employed. We believe this is important to our investors because it highlights the gross margin generated by our station portfolio. Finally, we exclude non-cash stock compensation and gain on assets transferred to affiliate from the measure as they do not represent cash activities related to the operation of the stations. We believe that station operating income is the most frequently used financial measure in determining the market value of a radio station or group of stations. We have observed that station operating income is commonly employed by firms that provide appraisal services to the broadcasting industry in valuing radio stations. Further, in each of the more than 140 radio station acquisitions we have completed since our inception, we have used station operating income as our primary metric to evaluate and negotiate the purchase price to be paid. Given its relevance to the estimated value of a radio station, we believe, and our experience indicates, that investors consider the measure to be useful in order to determine the value of our portfolio of stations. We believe that station operating income is the most commonly used financial measure employed by the investment community to compare the performance of radio station operators. Finally, station operating income is the primary measure that our management uses to evaluate the performance and results of our stations. Our management uses the measure to assess the performance of our station managers and our Board of Directors uses it to determine the relative performance of our executive management. As a result, in disclosing station operating income, we are providing our investors with an analysis of our performance that is consistent with that which is utilized by our management and our Board.

Station operating income is not a recognized term under GAAP and does not purport to be an alternative to operating income from continuing operations as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Additionally, station operating income is not intended to be a measure of free cash flow available for dividends, reinvestment in our business or other Company discretionary use, as it does not consider certain cash requirements such as interest payments, tax payments and debt service requirements. Station operating income should be viewed as a supplement to, and not a substitute for, results of operations presented on the basis of GAAP. We compensate for the limitations of using station operating income by using it only to supplement our GAAP results to provide a more complete understanding of the factors and trends affecting our business other than GAAP results alone. Station operating income has its limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Moreover, because not all companies use identical calculations, these presentations of station operating income may not be comparable to other similarly titled measures of other companies.

On a pro forma basis, which excludes the results of the stations contributed to CMP for the period January 1, 2006 through May 4, 2006, net revenues for the nine months ended September 30, 2007 increased $0.7 million to $243.9 million, an increase of 0.3% from the same period in 2006, due to organic growth across the station platform. Pro forma station operating income increased $0.8 million, an increase of 0.9% from the same period in 2006 primarily due to increased revenues.

Reconciliation of Non-GAAP Financial Measure. The following table reconciles station operating income to operating income as presented in the accompanying condensed consolidated statements of operations (the most directly comparable financial measure calculated and presented in accordance with GAAP) (dollars in thousands):

	For the Nine Months Ended September 30, 2007	**For the Nine Months Ended September 30, 2006**
Operating (loss) income	$(28,734)	$ 51,298
Depreciation and amortization	11,184	13,562
LMA fees	494	797
Corporate general and administrative expenses	19,761	22,845
Gain on assets transferred to affiliate		(2,548)
Impairment charge	81,335	
Costs associated with proposed merger	2,413	
Station operating income	$86,453	$ 85,954

Liquidity and Capital Resources

Our principal need for funds has been to fund working capital needs, capital expenditures, and interest and debt service payments. Our principal sources of funds for these requirements have been cash flows from financing activities, such as the proceeds from borrowings under credit facilities and cash flows from operations. Our principal needs for funds in the future are expected to include the need to fund acquisitions, interest and debt service payments, working capital needs and capital expenditures. We believe that our current projected cash flow from operations and present financing arrangements, including availability under our existing credit facilities, or borrowings that would be available from future financing arrangements, will be sufficient to meet our foreseeable capital needs for the next 12 months, including the funding of future acquisitions, operations and debt service. However, our cash flows from operations are subject to such factors as shifts in population, station listenership, demographics, audience tastes and fluctuations in preferred advertising media. In addition, borrowings under financing arrangements are subject to financial covenants that can restrict our financial flexibility. Further, our ability to obtain additional equity or debt financing is also subject to market conditions and operating performance. As such, there can be no assurance that we will be able to obtain such financing at terms, and on the timetable, that may be necessary to meet our future capital needs.

For the nine months ended September 30, 2007, net cash provided by operating activities decreased $14.9 million to $29.3 million from net cash provided by operating activities of $44.2 million for the nine months ended September 30, 2006. The decrease is primarily attributable to a $6.5 million decrease in accounts payable and accrued expenses, a $12.4 million decrease in deferred income taxes, a $3.7 million decrease in non-cash stock compensation, offset by an increase of $1.9 million in accounts receivable, a $2.2 million increase in prepaid expenses and other current assets, the absence of the $2.5 gain on assets contributed to CMP, and a net increase of $1.1 million in the remaining categories.

For the nine months ended September 30, 2007, net cash used in investing activities decreased $13.1 million to $4.9 million from net cash used in investing activities of $18.0 million for the nine months ended September 30, 2006. This decrease was primarily attributable to the absence of acquisitions and the purchases of certain intangible assets. In addition, capital expenditures decreased $4.5 million year over year.

For the nine months ended September 30, 2007, net cash used in financing activities decreased $10.4 million to $14.3 million compared to net cash used in financing activities of $24.7 million during the nine months ended September 30, 2006. Net cash used during the current period was primarily due to the refinancing of our credit facility offset by the absence of any significant repurchases of our stock.

Historical Acquisitions. During the nine months ended September 30, 2006, the Company completed its acquisition of two stations, WWXQ-FM and WXQW-FM, serving Huntsville, Alabama, and one station, KAYD-FM serving Beaumont, Texas. In connection with these acquisitions, we paid $5.5 million in cash. We also completed a transfer of a station in the Fort Walton Beach, Florida market plus $1.5 million in cash in exchange for another station. These stations were primarily acquired to complement our station portfolio and increase both our state and regional coverage of the United States.

Pending Acquisitions. As of September 30, 2007, we were not a party to any agreements to acquire stations.

2007 Refinancing

On June 11, 2007, the Company entered into an amendment to its existing credit agreement, dated June 7, 2006, by and among the Company, Bank of America, N.A., as administrative agent, and the lenders party thereto. The credit agreement, as amended, is referred to herein as the Amended Credit Agreement.

The Amended Credit Agreement provides for a replacement term loan facility, in the original aggregate principal amount of $750.0 million, to replace the prior term loan facility, which had an outstanding balance of approximately $713.9 million, and maintains the pre-existing $100.0 million revolving credit facility. The proceeds of the replacement term loan facility, fully funded on June 11, 2007, were used to repay the outstanding balances under the prior term loan facility and under the revolving credit facility.

Our obligations under the Amended Credit Agreement are collateralized by substantially all of our assets in which a security interest may lawfully be granted (including FCC licenses held by its subsidiaries), including, without limitation, intellectual property and all of the capital stock of our direct and indirect domestic subsidiaries (except for Broadcast Software International, Inc.) and 65% of the capital stock of certain first-tier foreign subsidiaries. In addition, our obligations under the Amended Credit Agreement are guaranteed by certain of our subsidiaries.

The Amended Credit Agreement contains terms and conditions customary for financing arrangements of this nature. The replacement term loan facility will mature on June 11, 2014 and will amortize in equal quarterly installments beginning on September 30, 2007, with 0.25% of the initial aggregate advances payable each quarter during the first six years of the term, and 23.5% due in each quarter during the seventh year. The revolving credit facility will mature on June 7, 2012 and, except at our option, the commitment will remain unchanged up to that date.

Borrowings under the replacement term loan facility bear interest, at our option, at a rate equal to LIBOR plus 1.75% or the Alternate Base Rate (defined as the higher of the Bank of America Prime Rate and the Federal Funds rate plus 0.50%) plus 0.75%. Borrowings under the revolving credit facility bear interest, at our option, at a rate equal to LIBOR plus a margin ranging between 0.675% and 2.0% or the Alternate Base Rate plus a margin ranging between 0.0% and 1.0% (in either case dependent upon our leverage ratio).

As of September 30, 2007, prior to the effect of the May 2005 Swap, the effective interest rate of the outstanding borrowings pursuant to the credit facility was approximately 7.11%. As of September 30, 2007, the effective interest rate inclusive of the May 2005 Swap is 6.520%.

Certain mandatory prepayments of the term loan facility will be required upon the occurrence of specified events, including upon the incurrence of certain additional indebtedness (other than under any incremental credit facilities under the Amended Credit Agreement) and upon the sale of certain assets.

The representations, covenants and events of default in the Amended Credit Agreement are customary for financing transactions of this nature. Events of default in the Amended Credit Agreement include, among others, (a) the failure to pay when due the obligations owing under the credit facilities; (b) the failure to perform (and not timely remedy, if applicable) certain covenants; (c) cross default and cross acceleration; (d) the occurrence of bankruptcy or insolvency events; (e) certain judgments against the Company or any of its subsidiaries; (f) the loss, revocation or suspension of, or any material impairment in the ability to use any of our material FCC licenses; (g) any representation or warranty made, or report, certificate or financial statement delivered, to the lenders subsequently proven to have been incorrect in any material respect; (h) the occurrence of a Change in Control (as defined in the Amended Credit Agreement); and (i) violation of certain financial covenants. Upon the occurrence of an event of default, the lenders may terminate the loan commitments, accelerate all loans and exercise any of their rights under the Amended Credit Agreement and the ancillary loan documents as a secured party. As of September 30, 2007, the Company was in compliance with all financial and non-financial covenants.

In connection with the retirement of our pre-existing credit facilities, we recorded a loss on early extinguishment of debt of $1.0 million for 2007, which was comprised of previously capitalized loan origination expenses. In connection with the new credit facility, we capitalized approximately $1.0 million of debt issuance costs, which will be amortized to interest expense over the life of the debt.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

At September 30, 2007, 100% of our long-term debt bears interest at variable rates. Accordingly, our earnings and after-tax cash flows are affected by changes in interest rates. Assuming the current level of borrowings at variable rates and assuming a one percentage point change in the average interest rate under these borrowings, it is estimated that our interest expense and net income would have changed by $1.0 million and $3.0 million for the three and nine months ended September 30, 2007, respectively. As part of our efforts to mitigate interest rate risk, in May 2005, we entered into a forward starting interest rate swap agreement that effectively fixed the interest rate, based on LIBOR, on $400.0 million of our current floating rate bank borrowings for a three-year period commencing March 2006. This agreement is intended to reduce our exposure to interest rate fluctuations and was not entered into for speculative purposes. Segregating the $338.2 million of borrowings outstanding at September 30, 2007 that are not subject to the interest rate swap and assuming a one percentage point change in the average interest rate under these borrowings, it is estimated that our interest expense and net income would have changed by $0.9 million and $2.5 million for the three and nine months ended September 30, 2007.

In the event of an adverse change in interest rates, management would likely take actions, in addition to the interest rate swap agreement similar to that discussed above, to further mitigate its exposure. In the event of an adverse change in interest rates, management would likely take actions, in addition to the interest rate swap agreement similar to that discussed above, to further mitigate its exposure. However, due to the uncertainty of the actions that would be taken and their possible effects, additional analysis is not possible at this time. Further, such analysis could not take into account the effects of any change in the level of overall economic activity that could exist in such an environment.

Item 4. ***Controls and Procedures***

We maintain a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. At the end of the period covered by this report, an evaluation was carried out under the supervision and with the

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participation of our management, including our Chairman, President and Chief Executive Officer (CEO) and our Executive Vice President, Treasurer and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, the CEO and CFO have concluded that, as a result of the previously disclosed material weakness in our internal control over financial reporting described in our Annual Report on Form 10-K for the year ended December 31, 2006, our disclosure controls and procedures are not effective as of September 30, 2007, due to the fact that the remediation efforts were not fully tested by the end of such period.
There have been no other changes in our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

We are from time to time involved in various legal proceedings that are handled and defended in the ordinary course of business. While we are unable to predict the outcome of these matters, management does not believe, based upon currently available facts, that the ultimate resolution of any such proceedings would have a material adverse effect on its overall financial condition or results of operations.

Item 1A. ***Risk Factors***

There have been no material changes to the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2006 and our quarterly report on form 10-Q for the quarter ended June 30, 2007.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

Not applicable.

Item 3. ***Defaults upon Senior Securities***

Not applicable.

Item 4. ***Submission of Matters to a Vote of Security Holders***

Not applicable.

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Item 5. ***Other Information***
Not applicable.
Item 6. ***Exhibits***

31.1	Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

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

CUMULUS MEDIA INC.

Date: November 8, 2007

By: /s/ Martin R. Gausvik
Martin R. Gausvik
Executive Vice President,
Treasurer and Chief Financial Officer

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