

ALASKA COMMUNICATIONS SYSTEMS GROUP INC

Form 10-Q

August 03, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 000-28167

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or Other Jurisdiction  
of Incorporation or Organization)

**52-2126573**

(I.R.S. Employer  
Identification No.)

**600 Telephone Avenue, Anchorage, Alaska 99503**

(Address of Principal Executive Offices) (Zip Code)

**(907) 297-3000**

(Registrant's Telephone Number, Including Area Code)

**Not Applicable**

(Former name, former address and former three months, 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 ☒ 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 and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

Yes ☐ No ☒

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes ☐ No ☐

**APPLICABLE ONLY TO CORPORATE ISSUERS :**

The number of shares outstanding of the registrant's Common Stock, as of August 1, 2007, was 42,810,403.



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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**  
**Consolidated Balance Sheets**  
(In Thousands Except Per Share Amounts)

|                                                                    | <b>Unaudited</b> | <b>December</b> |
|--------------------------------------------------------------------|------------------|-----------------|
|                                                                    | <b>June 30,</b>  | <b>31,</b>      |
|                                                                    | <b>2007</b>      | <b>2006</b>     |
| <b>Assets</b>                                                      |                  |                 |
| Current assets:                                                    |                  |                 |
| Cash and cash equivalents                                          | \$ 38,275        | \$ 36,860       |
| Restricted cash                                                    | 2,559            | 1,700           |
| Accounts receivable-trade, net of allowance of \$8,467 and \$7,434 | 40,188           | 39,801          |
| Materials and supplies                                             | 10,073           | 7,977           |
| Prepayments and other current assets                               | 4,176            | 3,514           |
| Total current assets                                               | 95,271           | 89,852          |
| Property, plant and equipment                                      | 1,184,583        | 1,164,450       |
| Less: accumulated depreciation and amortization                    | 796,559          | 767,907         |
| Property, plant and equipment, net                                 | 388,024          | 396,543         |
| Goodwill                                                           | 38,403           | 38,403          |
| Intangible assets                                                  | 21,604           | 21,604          |
| Debt issuance cost                                                 | 8,408            | 9,437           |
| Deferred charges and other assets                                  | 9,885            | 6,482           |
| Total assets                                                       | \$ 561,595       | \$ 562,321      |
| <b>Liabilities and Stockholders Equity (Deficit)</b>               |                  |                 |
| Current liabilities:                                               |                  |                 |
| Current portion of long-term obligations                           | \$ 4,961         | \$ 1,025        |
| Accounts payable affiliates                                        |                  | 2,942           |
| Accounts payable, accrued and other current liabilities            | 61,782           | 62,307          |
| Advance billings and customer deposits                             | 9,966            | 10,667          |
| Total current liabilities                                          | 76,709           | 76,941          |
| Long-term obligations, net of current portion                      | 432,680          | 437,188         |
| Other deferred credits and long-term liabilities                   | 74,730           | 72,881          |
| Total liabilities                                                  | 584,119          | 587,010         |
| Stockholders equity (deficit):                                     |                  |                 |
| Common stock, \$.01 par value; 145,000 authorized                  | 428              | 423             |
| Additional paid in capital in excess of par value                  | 310,297          | 311,975         |

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|                                                      |            |            |
|------------------------------------------------------|------------|------------|
| Accumulated deficit                                  | (338,653)  | (338,653)  |
| Accumulated other comprehensive (loss) income        | 5,404      | 1,566      |
| Total stockholders' equity (deficit)                 | (22,524)   | (24,689)   |
| Commitments and contingencies                        |            |            |
| Total liabilities and stockholders' equity (deficit) | \$ 561,595 | \$ 562,321 |

*See Notes to Consolidated Financial Statements*

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**  
**Consolidated Statements of Operations**  
**(Unaudited, In Thousands Except Per Share Amounts)**

|                                                       | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|-------------------------------------------------------|----------------------------------------|-------------|--------------------------------------|-------------|
|                                                       | <b>2007</b>                            | <b>2006</b> | <b>2007</b>                          | <b>2006</b> |
| Operating revenues:                                   |                                        |             |                                      |             |
| Wireline                                              | \$ 59,906                              | \$ 58,125   | \$ 118,737                           | \$ 116,259  |
| Wireless                                              | 33,326                                 | 26,946      | 65,068                               | 51,454      |
| Total operating revenues                              | 93,232                                 | 85,071      | 183,805                              | 167,713     |
| Operating expenses:                                   |                                        |             |                                      |             |
| Wireline (exclusive of depreciation and amortization) | 44,516                                 | 41,537      | 88,365                               | 83,642      |
| Wireless (exclusive of depreciation and amortization) | 17,839                                 | 14,931      | 33,699                               | 28,745      |
| Depreciation and amortization                         | 16,408                                 | 16,034      | 32,696                               | 33,131      |
| Loss on disposal of assets, net                       | 21                                     | 383         | 24                                   | 1,105       |
| Total operating expenses                              | 78,784                                 | 72,885      | 154,784                              | 146,623     |
| Operating income                                      | 14,448                                 | 12,186      | 29,021                               | 21,090      |
| Other income and expense:                             |                                        |             |                                      |             |
| Interest expense                                      | (7,715)                                | (7,643)     | (15,325)                             | (15,617)    |
| Loss on extinguishment of debt                        |                                        |             |                                      | (9,650)     |
| Interest income                                       | 506                                    | 402         | 1,035                                | 794         |
| Other                                                 | (72)                                   | 8,561       | 8                                    | 8,517       |
| Total other income and expense                        | (7,281)                                | 1,320       | (14,282)                             | (15,956)    |
| Income before income tax                              | 7,167                                  | 13,506      | 14,739                               | 5,134       |
| Income tax expense                                    | (98)                                   |             | (105)                                |             |
| Net income                                            | \$ 7,069                               | \$ 13,506   | \$ 14,634                            | \$ 5,134    |
| Net income per share:                                 |                                        |             |                                      |             |
| Basic                                                 | \$ 0.17                                | \$ 0.32     | \$ 0.34                              | \$ 0.12     |
| Diluted                                               | \$ 0.16                                | \$ 0.31     | \$ 0.33                              | \$ 0.12     |
| Weighted average shares outstanding                   |                                        |             |                                      |             |
| Basic                                                 | 42,747                                 | 41,989      | 42,566                               | 41,891      |

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Diluted | 44,145 | 43,342 | 44,061 | 43,164 |
|---------|--------|--------|--------|--------|

*See Notes to Consolidated Financial Statements*

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**  
**Consolidated Statements of Stockholders' Equity (Deficit)**  
**Six months Ended June 30, 2007**  
**(Unaudited, In Thousands Except Per Share Amounts)**

|                                                                                     | Shares | Common<br>Stock | Treasury<br>Stock | Paid in<br>Capital in<br>Excess of<br>Par | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Stockholders'<br>Equity<br>(Deficit) |
|-------------------------------------------------------------------------------------|--------|-----------------|-------------------|-------------------------------------------|------------------------|-----------------------------------------------------------|--------------------------------------|
| Balance,<br>December 31, 2006                                                       |        | \$ 423          | \$                | \$ 311,975                                | \$ (338,653)           | \$ 1,566                                                  | \$ (24,689)                          |
| Components of<br>comprehensive<br>income (loss):                                    |        |                 |                   |                                           |                        |                                                           |                                      |
| Comprehensive<br>income<br>(loss) 3 months ended<br>March 31                        |        |                 |                   |                                           | 7,565                  | (2,285)                                                   | 5,280                                |
| Comprehensive<br>income 3 months<br>ended June 30                                   |        |                 |                   |                                           | 7,069                  | 6,123                                                     | 13,192                               |
| Total comprehensive<br>income                                                       |        |                 |                   |                                           |                        |                                                           | 18,472                               |
| Dividends declared                                                                  |        |                 |                   | (3,765)                                   | (14,634)               |                                                           | (18,399)                             |
| Stock-based<br>compensation costs                                                   |        |                 |                   | 3,333                                     |                        |                                                           | 3,333                                |
| Surrender of shares to<br>cover withholding<br>taxes on stock-based<br>compensation | 153    |                 |                   | (2,311)                                   |                        |                                                           | (2,311)                              |
| Issuance of shares of<br>common stock<br>pursuant to stock<br>plans, \$.01 par      | 488    | 5               |                   | 1,065                                     |                        |                                                           | 1,070                                |
| Balance, June 30,<br>2007                                                           |        | \$ 428          | \$                | \$ 310,297                                | \$ (338,653)           | \$ 5,404                                                  | \$ (22,524)                          |

*See Notes to Consolidated Financial Statements*

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**  
**Consolidated Statements of Cash Flows**  
**(Unaudited, In Thousands)**

|                                                                                          | <b>Six Months Ended<br/>June 30,</b> |             |
|------------------------------------------------------------------------------------------|--------------------------------------|-------------|
|                                                                                          | <b>2007</b>                          | <b>2006</b> |
| Cash Flows from Operating Activities:                                                    |                                      |             |
| Net income                                                                               | \$ 14,634                            | \$ 5,134    |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: |                                      |             |
| Depreciation and amortization                                                            | 32,696                               | 33,131      |
| Loss on disposal of assets, net                                                          | 24                                   | 1,105       |
| Gain on sale of long-term investments                                                    | (152)                                | (6,685)     |
| Amortization of debt issuance costs and original issue discount                          | 952                                  | 4,213       |
| Stock-based compensation                                                                 | 3,333                                | 3,285       |
| Other non-cash expenses                                                                  | 263                                  |             |
| Changes in components of assets and liabilities:                                         |                                      |             |
| Accounts receivable and other current assets                                             | (3,059)                              | (544)       |
| Accounts payable and other current liabilities                                           | (3,476)                              | 1,772       |
| Deferred charges and other assets                                                        | 162                                  | 44          |
| Other deferred credits                                                                   | 1,263                                | (3,534)     |
| Net cash provided by operating activities                                                | 46,640                               | 37,921      |
| Cash Flows from Investing Activities:                                                    |                                      |             |
| Investment in construction and capital expenditures                                      | (23,564)                             | (20,658)    |
| Change in unsettled construction and capital expenditures                                | (808)                                | (6,279)     |
| Purchase of short-term investments                                                       | (36,040)                             | (19,925)    |
| Proceeds from sale of short-term investments                                             | 36,040                               | 30,450      |
| Proceeds from liquidation of long-term investments                                       | 162                                  | 7,663       |
| Placement of funds in restricted account                                                 | (2,979)                              |             |
| Release of funds from escrow account                                                     | 2,120                                | 965         |
| Net cash used by investing activities                                                    | (25,069)                             | (7,784)     |
| Cash Flows from Financing Activities:                                                    |                                      |             |
| Repayments of long-term debt                                                             | (632)                                | (61,463)    |
| Proceeds from the issuance of long-term debt                                             |                                      | 52,900      |
| Debt issuance costs                                                                      |                                      | (1,349)     |
| Payment of cash dividend on common stock                                                 | (18,283)                             | (17,356)    |
| Payment of withholding taxes on stock-based compensation                                 | (2,311)                              | (854)       |
| Proceeds from the issuance of common stock                                               | 1,070                                | 1,231       |
| Net cash used by financing activities                                                    | (20,156)                             | (26,891)    |
| Increase in cash and cash equivalents                                                    | 1,415                                | 3,246       |
| Cash and cash equivalents, beginning of period                                           | 36,860                               | 28,877      |

|                                          |           |           |
|------------------------------------------|-----------|-----------|
| Cash and cash equivalents, end of period | \$ 38,275 | \$ 32,123 |
| Supplemental Cash Flow Data:             |           |           |
| Interest paid                            | \$ 14,285 | \$ 16,953 |
| Income taxes paid                        | 353       |           |
| Supplemental Noncash Transactions:       |           |           |
| Property acquired under captial leases   | \$ 51     | \$        |
| Dividend declared, but not paid          | 9,210     | 9,060     |

*See Notes to Consolidated Financial Statements*

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements**

**(Unaudited, In Thousands Except Per Share Amounts)**

**1. DESCRIPTION OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Alaska Communications Systems Group, Inc., a Delaware corporation, and its Subsidiaries (the Company or ACS Group), is engaged principally in providing wireline and wireless services to its retail consumer, business and wholesale customers in the State of Alaska through its telecommunications subsidiaries. The Company's wireline activities include local telephone, Internet and interexchange services. The Company was formed in October of 1998 for the purpose of acquiring and operating telecommunications properties.

The accompanying consolidated financial statements for the Company represent the consolidated financial position, results of operations and cash flows principally of the following entities:

ACS Group

Alaska Communications Systems Holdings, Inc. ( ACS Holdings )

ACS of Anchorage, Inc. ( ACSA )

ACS of the Northland, Inc. ( ACSN )

ACS of Alaska, Inc. ( ACSAK )

ACS of Fairbanks, Inc. ( ACSF )

ACS Internet, Inc. ( ACSI )

ACS Long Distance, Inc. ( ACSLD )

ACS Wireless, Inc. ( ACSW )

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. However, the Company believes the disclosures which are made are adequate to make the information presented not misleading. The consolidated financial statements and footnotes included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Certain reclassifications have been made to the 2006 financial statements to make them conform to the current presentation. The most significant of these reclassifications is the presentation of the business segment footnote. The note was modified to more accurately represent the way the Company's management views the operations of the business. The presentation focuses on wireline and wireless activities rather than individual product lines offered under those segments. See Note 6, Business Segments for further detail. Additionally the Company reclasses additional paid in capital and accumulated deficit in the equity section of the Consolidated Balance Sheets and on the Statement of Stockholders Equity (Deficit). This change was made because management believes it is a more appropriate presentation to show dividends paid as a charge to retained earnings (accumulated deficit) in periods where there were earnings, rather than a reduction of additional paid-in capital.

In the opinion of management, the financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations and cash flows for all periods presented. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results of operations which might be expected for the entire year or any other interim periods.

***Revenue Recognition***

Access revenue is recognized when earned. The Company participates in access revenue pools with other telephone companies. Such pools are funded by toll revenue and/or access charges regulated by the Regulatory

Commission of Alaska ( RCA ) within the intrastate jurisdiction and the Federal Communications Commission ( FCC ) within the interstate jurisdiction. Much of the interstate access revenue is initially recorded based on estimates. These estimates are derived from interim financial statements, available separations studies and the most recent information available about achieved rates of return. These estimates are subject to adjustment in future accounting periods as additional operational information becomes available. To the extent that disputes arise over revenue settlements, the Company's policy is to defer revenue collected until settlement methodologies are resolved and finalized. At June 30, 2007 and December 31, 2006, the Company had liabilities of \$16,406 and \$21,448, respectively, related to its estimate of refundable revenue. Actual results could vary significantly from this estimate.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements**

**(Unaudited, In Thousands Except Per Share Amounts)**

**1. DESCRIPTION OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(Continued)**

Wireless revenue is materially impacted by seasonal factors. Wireless revenue, particularly roaming revenue, declines in the winter months and increases in the summer months due to Alaska's northern latitude and the wide swing in available daylight, changes in weather patterns between summer and winter and their effect on business, tourism and subscriber calling patterns. Non-ACS customers roaming on our network resulted in third-party roaming revenue increasing to \$4,467 from \$3,638 for the three months ended June 30, 2007 and 2006, respectively, and to \$7,711 from \$5,495 for the six months ended June 30, 2007 and 2006, respectively. Our wireline segment experiences similar seasonal effects, but we do not believe these effects are material.

*Regulatory Accounting and Regulation*

The local telephone exchange operations of the Company account for costs in accordance with the accounting principles for regulated enterprises prescribed by Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*. This accounting recognizes the economic effects of rate regulation by recording cost and a return on investment as such amounts are recovered through rates authorized by regulatory authorities. Accordingly, under SFAS No. 71, plant and equipment is depreciated over lives approved by regulators and certain costs and obligations are deferred based upon approvals received from regulators to permit recovery of such amounts in future years.

Effective January 1, 2003, the Company implemented, higher depreciation rates for its regulated telephone plant for the interstate jurisdiction, which management believes approximate the economically useful lives of the underlying plant. As a result, the Company has recorded a regulatory asset under SFAS No. 71 of \$71,318 and \$65,724 as of June 30, 2007 and December 31, 2006, respectively, related to depreciation of the regulated telephone plant allocable to its intrastate and local jurisdictions. If the Company were not following SFAS No. 71, it would have recorded additional cumulative depreciation expense for the three and six months ended June 30, 2007, of \$2,806 and \$5,594, respectively, for the intrastate and local jurisdictions. The Company also has a regulatory liability of \$62,025 and \$61,486 at June 30, 2007 and December 31, 2006, respectively, related to accumulated removal costs. If the Company were not following SFAS No. 71, it would have followed SFAS No. 143, *Accounting for Asset Retirement Obligations*. Non-regulated revenues incurred by the local telephone exchange operations and non-regulated operations of the Company are not accounted for under SFAS No. 71 principles. SFAS No. 71 also requires revenue generated between regulated and non-regulated group companies not be eliminated on consolidations; these revenues totaled \$9,203 and \$8,000 for the three months ended June 30, 2007 and 2006, respectively, and \$18,329 and \$15,560 for the six months ended June 30, 2007 and 2006, respectively.

*Income Taxes*

The Company recorded \$98 and \$7 for income taxes for the quarterly periods ended June 30 and March 31, 2007, respectively. The Company recorded zero expense for the comparative quarterly periods in 2006. The Company has recorded valuation allowances to fully reserve its deferred tax assets, as management believes it is more likely than not that these assets will not be realized. The Company will continue to assess the recoverability of the deferred tax assets and the related valuation allowance, including the consideration of its ability to generate sustainable future taxable income. To the extent the Company continues to generate taxable income in future years and it is determined more likely than not that such valuation allowance is no longer required, the tax benefit of the remaining deferred tax assets will be recognized at such time. On January 1, 2007, the Company had \$120,478 of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in any future periods. At June 30, 2007, the Company had \$112,285 of unrecognized tax benefits.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes*, which was effective for the Company on January 1, 2007. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition,

classification, interest and penalties, accounting in interim periods, disclosure and transition. The impact of the Company's reassessment of its tax positions in accordance with the adoption of FIN 48 did not have a material impact on the results of operations,

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements**

**(Unaudited, In Thousands Except Per Share Amounts)**

**1. DESCRIPTION OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(Continued)**

financial condition or liquidity. The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense. As of June 30, 2007, the Company had no accrued income tax interest or penalties. Tax returns prior to 2003 are no longer subject to examination by major tax jurisdictions.

*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the Company's consolidated financial statements and the accompanying notes. Actual results could differ from those estimates.

*Taxes Collected from Customers and Remitted to Government Authorities*

In June 2006, the FASB Emerging Issues Task Force (EITF) Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Government Authorities Should Be Presented in the Income Statement* was issued. EITF 06-3 was effective for accounting periods beginning after December 15, 2006. The consensus reached in this Issue is that the presentation of taxes on either a gross (included in revenue and costs) or a net (excluded from revenues) basis is an accounting policy decision and should be disclosed pursuant to Opinion 22. We currently exclude taxes, collected from customers and payable to government authorities, from revenue. Taxes payable to government authorities are presented as a liability on the Consolidated Balance Sheets.

**2. NEW ACCOUNTING STANDARDS**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective as of the beginning of our 2008 fiscal year. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS No. 159 are effective as of the beginning of our 2008 fiscal year. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

**3. ASSET RETIREMENT OBLIGATION**

In March 2005, the FASB issued FIN 47, *Accounting for Conditional Asset Retirement Obligations*. FIN 47 was effective for the Company on December 31, 2005, and required it to recognize asset retirement obligations which are conditional on a future event. Uncertainty about the timing or settlement of the obligation is factored into the measurement of the liability. The Company has a regulatory liability of \$62,025 and \$61,486 at June 30, 2007 and December 31, 2006, respectively, related to accumulated removal costs for its local telephone subsidiaries. Consistent with the industry, the Company follows SFAS No. 71, for asset retirement obligations associated with its regulated telephone plant. The Company's assets are pooled and the depreciable lives set by the regulators include a removal component which, in effect, accounts for the cost of removal. Non-regulated operations of the Company are accounted for under the principles of SFAS No. 143 and FIN 47 for which the Company has recorded a retirement obligation of \$1,296 and \$1,171 as of June 30, 2007 and December 31, 2006, respectively. These costs were recorded as a result of the Company's estimated obligation related to the removal of certain cell sites at the end of their operating lease term, adjusted for accretion over the life of the lease.

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The following table outlines the changes in the accumulated retirement obligation liability:

|                                 |          |
|---------------------------------|----------|
| Balance, January 1, 2006        | \$ 836   |
| Asset retirement obligation     | 239      |
| Accretion expense               | 100      |
| Settlement of lease obligations | (4)      |
| Balance, December 31, 2006      | \$ 1,171 |
| Asset retirement obligation     | 80       |
| Accretion expense               | 47       |
| Settlement of lease obligations | (2)      |
| Ending Balance, June 30, 2007   | \$ 1,296 |

**4. EARNINGS PER SHARE**

Earnings per share are based on the weighted average number of shares of common stock and dilutive potential common share equivalents outstanding. Basic earnings per share includes no dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of an entity. The Company includes dilutive stock options based on the treasury stock method. Potential common share equivalents, which consisted of options and restricted stock granted to employees, and deferred shares granted to directors resulted in dilutive earnings per share for the three and six months ended June 30, 2007 and 2006.

Earnings per share for the three and six months ended June 30, 2007 and 2006 were as follows:

|                                                            | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|------------------------------------------------------------|----------------------------------------|-------------|--------------------------------------|-------------|
|                                                            | <b>2007</b>                            | <b>2006</b> | <b>2007</b>                          | <b>2006</b> |
| Numerator net income                                       | \$ 7,069                               | \$ 13,506   | \$ 14,634                            | \$ 5,134    |
| Denominator weighted average shares outstanding:           |                                        |             |                                      |             |
| Basic shares                                               | 42,747                                 | 41,989      | 42,566                               | 41,891      |
| Dilutive impact of options, restricted and deferred shares | 1,398                                  | 1,353       | 1,495                                | 1,273       |
| Dilutive shares                                            | 44,145                                 | 43,342      | 44,061                               | 43,164      |
| Earnings per share:                                        |                                        |             |                                      |             |
| Basic                                                      | \$ 0.17                                | \$ 0.32     | \$ 0.34                              | \$ 0.12     |
| Diluted                                                    | \$ 0.16                                | \$ 0.31     | \$ 0.33                              | \$ 0.12     |

**5. STOCK INCENTIVE PLANS**

Under various plans, ACS Group, through the Compensation Committee of the Board of Directors, may grant stock options, stock appreciation rights and other awards to officers, employees and non-employee directors. At June 30, 2007, ACS Group has reserved a total of 11,560 shares (11.56 million) of authorized common stock for issuance under the plans. In general, options under the plans vest ratably over three, four or five years. After the plans

terminate, all shares granted under the plan, prior to its termination, continue to vest under the terms of the grant when it was awarded.

Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements****(Unaudited, In Thousands Except Per Share Amounts)****5. STOCK INCENTIVE PLANS (Continued)***SFAS No. 123(R), Share-Based Payment*

Total compensation cost for share-based payments under SFAS No. 123(R) was \$3,333 and \$3,285 for the six months ended June 30, 2007 and 2006, respectively. Accrued compensation expense associated with restricted shares yet to be awarded was zero and \$305 for the six months ended June 30, 2007 and 2006, respectively. The Company did not recognize a tax benefit from the stock compensation expense because the Company considers it more likely than not that the related deferred tax assets, which have been reduced by a full valuation allowance, will not be realized.

There were 579 and 721 restricted stock grants for the six months ended June 30, 2007 and 2006, respectively. The following table summarizes the assumptions used for valuation of equity instruments awarded during the six months ended June 30, 2007 and 2006.

|                                      | 2007  | 2006  |
|--------------------------------------|-------|-------|
| Restricted stock grants:             |       |       |
| Risk free rate                       | 5.25% | 4.50% |
| Dividend yield                       | 5.49% | 7.94% |
| Expected, per annum, forfeiture rate | 4.47% | 2.00% |

**6. RETIREMENT PLANS**

Pension benefits for substantially all of the Company's employees are provided through the Alaska Electrical Pension Plan ( AEPP ). The Company pays a contractual hourly amount based on employee classification or base compensation. As a multi-employer defined benefit plan, the accumulated benefits and plan assets are not determined for, or allocated separately to, the individual employer. The Company also provides a 401(k) retirement savings plan covering substantially all of its employees. The Company provides no matching of employee contributions to the 401(k) retirement savings plan.

The Company has a separate defined benefit plan that covers certain employees previously employed by Century Telephone Enterprise, Inc. ( CenturyTel Plan ). This plan was transferred to the Company in connection with the acquisition of CenturyTel, Inc.'s Alaska properties. Existing plan assets and liabilities of the CenturyTel Plan were transferred to the ACS Retirement Plan on September 1, 1999. Accrued benefits under the ACS Retirement Plan were determined in accordance with the provisions of the CenturyTel Plan. Upon completion of the transfer to the Company, covered employees ceased to accrue benefits under the plan. On November 1, 2000, the ACS Retirement Plan was amended to conform early retirement reduction factors and various other terms to those provided by the AEPP. As a result of this amendment, prior service cost of \$1,992 was recorded and will be amortized over the expected service life of the plan participants at the date of the amendment. The Company uses the traditional unit credit method for the determination of pension cost for financial reporting and funding purposes and complies with the funding requirements under the Employee Retirement Income Security Act of 1974 ( ERISA ). The Company uses a December 31 measurement date for the plan. The Company is considering making a contribution in the third quarter of 2007 to the 2006 plan year, however the amount has yet to be determined. In March of 2006, the Company contributed \$600 in cash for the 2005 plan year.

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements****(Unaudited, In Thousands Except Per Share Amounts)****6. RETIREMENT PLANS (Continued)**

The following table represents the net periodic pension expense for the ACS Retirement Plan for the three and six months ended June 30, 2007 and 2006:

|                                    | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|------------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                    | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                    | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
| Interest cost                      | \$ 207                    | \$ 189      | \$ 402                  | \$ 381      |
| Expected return on plan assets     | (261)                     | (214)       | (508)                   | (429)       |
| Amortization of loss               | 84                        | 114         | 161                     | 222         |
| Amortization of prior service cost | 51                        | 50          | 102                     | 101         |
| Net periodic pension expense       | \$ 81                     | \$ 139      | \$ 157                  | \$ 275      |

**7. BUSINESS SEGMENTS**

The Company has two reportable segments: wireline and wireless. The wireline segment in turn has three unique product lines: local telephone, Internet and interexchange. Local telephone provides landline telecommunications services and consists of local telephone service and other revenue, and network access. Internet provides Internet service and advanced IP based private networks. Interexchange provides switched and dedicated long distance services. The wireless segment provides wireless telecommunications service. Each reportable segment is a strategic business offering different services than those offered by the other segments. The Company evaluates the performance of its segments based on operating income (loss) and other quantitative factors related to the overall contribution of individual products and services to total Company performance.

The Company also incurs interest expense, interest income and other operating and non-operating income and expense at the corporate level which are not allocated to the business segments, nor are they evaluated by the chief operating decision maker in analyzing the performance of the business segments. These non-operating income and expense items are provided in the accompanying table under the caption All Other in order to assist the users of these financial statements in reconciling the operating results and total assets of the business segments to the consolidated financial statements. Common use assets are held at ACS Holdings and are allocated to the business segments based on operating revenue. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

The following table illustrates selected financial data for each segment as of and for the three months ended June 30, 2007:

|                               | <b>Wireline</b> | <b>Wireless</b> | <b>All Other</b> | <b>Eliminations</b> | <b>Total</b> |
|-------------------------------|-----------------|-----------------|------------------|---------------------|--------------|
| Operating revenues            | \$ 62,689       | \$ 33,341       | \$ 4,216         | \$(7,014)           | \$ 93,232    |
| Depreciation and amortization | 10,792          | 3,001           | 2,615            |                     | 16,408       |
| Operating income (loss)       | 2,042           | 10,919          | 1,487            |                     | 14,448       |
| Interest expense              | (219)           | (1)             | (7,495)          |                     | (7,715)      |
| Interest income               | 1               |                 | 505              |                     | 506          |
| Income tax (expense) benefit  | (679)           | (4,491)         | 5,072            |                     | (98)         |
| Net income (loss)             | 1,145           | 6,426           | (502)            |                     | 7,069        |
| Total assets                  | 393,141         | 165,671         | 2,783            |                     | 561,595      |
| Capital expenditures          | 5,480           | 6,910           | 1,154            |                     | 13,544       |

Operating revenue disclosed above includes inter-segment operating revenue of \$16,217 of which \$7,014 is eliminated. By segment, affiliate revenue balances are as follows: wireline, \$11,355 of which \$2,783 is eliminated;

wireless, \$646 of which \$15 is eliminated; and all other, \$4,216 of which \$4,216 is eliminated. In accordance with SFAS No. 71, affiliate revenue and expense between local telephone and all other segments is not eliminated.

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements****(Unaudited, In Thousands Except Per Share Amounts)****7. BUSINESS SEGMENTS (Continued)**

The following table illustrates selected financial data for each segment as of and for the three months ended June 30, 2006:

|                               | Wireline  | Wireless  | All Other | Eliminations | Total     |
|-------------------------------|-----------|-----------|-----------|--------------|-----------|
| Operating revenues            | \$ 59,956 | \$ 26,960 | \$ 2,633  | \$(4,478)    | \$ 85,071 |
| Depreciation and amortization | 12,098    | 2,868     | 1,068     |              | 16,034    |
| Operating income (loss)       | 2,528     | 8,267     | 1,391     |              | 12,186    |
| Interest expense              | (133)     | (1)       | (7,509)   |              | (7,643)   |
| Interest income               |           |           | 402       |              | 402       |
| Income tax (expense) benefit  | (1,088)   | (3,398)   | 4,486     |              |           |
| Net income (loss)             | 1,307     | 4,868     | 7,331     |              | 13,506    |
| Total assets                  | 420,136   | 138,958   | 6,152     |              | 565,246   |
| Capital expenditures          | 7,446     | 4,039     | 758       |              | 12,243    |

Operating revenue disclosed above includes inter-segment operating revenue of \$12,478 of which \$4,478 is eliminated. By segment, affiliate revenue balances are as follows: wireline, \$9,156 of which \$1,831 is eliminated; wireless, \$689 of which \$14 is eliminated; and all other, \$2,633 of which \$2,633 is eliminated. In accordance with SFAS No. 71, affiliate revenue and expense between local telephone and all other segments is not eliminated.

The following table illustrates selected financial data for each segment as of and for the six months ended June 30, 2007:

|                               | Wireline   | Wireless  | All Other | Eliminations | Total      |
|-------------------------------|------------|-----------|-----------|--------------|------------|
| Operating revenues            | \$ 123,867 | \$ 65,093 | \$ 6,847  | \$(12,002)   | \$ 183,805 |
| Depreciation and amortization | 23,024     | 6,009     | 3,663     |              | 32,696     |
| Operating income (loss)       | 3,599      | 22,492    | 2,930     |              | 29,021     |
| Interest expense              | (438)      | (2)       | (14,885)  |              | (15,325)   |
| Interest income               | 1          |           | 1,034     |              | 1,035      |
| Income tax (expense) benefit  | (1,050)    | (9,239)   | 10,184    |              | (105)      |
| Net income (loss)             | 2,111      | 13,251    | (728)     |              | 14,634     |
| Total assets                  | 393,141    | 165,671   | 2,783     |              | 561,595    |
| Capital expenditures          | 10,529     | 10,901    | 2,185     |              | 23,615     |

Operating revenue disclosed above includes inter-segment operating revenue of \$30,331 of which \$12,002 is eliminated. By segment, affiliate revenue balances are as follows: wireline, \$22,224 of which \$5,130 is eliminated; wireless, \$1,260 of which \$25 is eliminated; and all other, \$6,847 of which \$6,847 is eliminated. In accordance with SFAS No. 71, affiliate revenue and expense between local telephone and all other segments is not eliminated.

The following table illustrates selected financial data for each segment as of and for the six months ended June 30, 2006:

|                                | Wireline   | Wireless  | All Other | Eliminations | Total      |
|--------------------------------|------------|-----------|-----------|--------------|------------|
| Operating revenues             | \$ 119,624 | \$ 51,479 | \$ 6,049  | \$(9,439)    | \$ 167,713 |
| Depreciation and amortization  | 24,657     | 5,578     | 2,896     |              | 33,131     |
| Operating income (loss)        | 3,517      | 15,396    | 2,177     |              | 21,090     |
| Interest expense               | (271)      | (2)       | (15,344)  |              | (15,617)   |
| Loss on extinguishment of debt |            |           | (9,650)   |              | (9,650)    |
| Interest income                |            |           | 794       |              | 794        |
| Income tax (expense) benefit   | (1,836)    | (6,330)   | 8,166     |              |            |

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|                      |         |         |         |         |
|----------------------|---------|---------|---------|---------|
| Net income (loss)    | 1,410   | 9,064   | (5,340) | 5,134   |
| Total assets         | 420,136 | 138,958 | 6,152   | 565,246 |
| Capital expenditures | 13,518  | 5,812   | 1,328   | 20,658  |

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, In Thousands Except Per Share Amounts)**

**7. BUSINESS SEGMENTS (Continued)**

Operating revenue disclosed above includes inter-segment operating revenue of \$24,999 of which \$9,439 is eliminated. By segment, affiliate revenue balances are as follows: wireline, \$17,618 of which \$3,365 is eliminated; wireless, \$1,332 of which \$25 is eliminated; and all other, \$6,049 of which \$6,049 is eliminated. In accordance with SFAS No. 71, affiliate revenue and expense between local telephone and all other segments is not eliminated.

**8. COMMITMENTS AND CONTINGENCIES**

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business and has recorded litigation reserves of \$25 at June 30, 2007 against certain current claims and legal actions. The Company believes that the disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

**9. OTHER EVENTS**

In March 2007, the Company entered into a Settlement Agreement with General Communications, Inc. ( GCI ) resolving certain disputes related to the Company's provision to GCI of unbundled network elements ( UNEs ). The parties have agreed to dismiss each party's pending appeal before the United States Court of Appeals of the Order of the FCC related to the Company's petition filed on September 30, 2005 and the Court in fact dismissed the appeals.

In addition to, and in consideration of the forgoing, the Agreement required both parties to enter a Global Interconnection Agreement ( GIA ), which covers several of the Company's local exchange markets. The GIA sets forth the terms for certain statewide rates offered by the Company to GCI for UNEs and interconnection rights. The term of the Agreement is five (5) years initially, with one year automatic extensions until terminated. The rates set forth in the agreement became effective on April 1, 2007. The GIA was approved by the RCA in June, 2007.

On July 6, 2007, the Company gave notice that it was redeeming 100% of the principal outstanding balance of its 9 7/8% Senior Notes Due 2011, as of August 15, 2007. The Company expects to pay \$4,239 exclusive of accrued and unpaid interest.

On July 17, 2007 the Company retained a third-party to perform a study regarding routing of its proposed fiber optic cable system to the Pacific Northwest. The Company expects to spend approximately \$5,400 to complete this study.

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

**Forward Looking Statements and Analysts' Reports**

This Form 10-Q and future filings by Alaska Communications Systems Group, Inc. and its consolidated subsidiaries ( we , our , us the Company, and ACS Group ) on Forms 10-K, 10-Q and 8-K and the documents incorporated therein by reference include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these provisions. All statements other than statements of historical fact are forward-looking statements for purposes of federal and state securities laws, including statements about anticipated future operating and financial performance, financial position and liquidity, growth opportunities and growth rates, pricing plans, acquisition and divestiture opportunities, business prospects, strategic alternatives, business strategies, regulatory and competitive outlook, investment and expenditure plans, financing needs and availability and other similar forecasts and statements of expectation and statements of assumptions underlying any of the foregoing. Words such as aims, anticipates, believes, could, estimates, expects, hopes, intends, may, plans, projects, seeks, should and variations of the expressions are intended to identify these forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. Forward-looking statements by us are based on estimates, projections, beliefs and assumptions of management and are not guarantees of future performance. Such forward-looking statements may be contained in this Form 10-Q under Management's discussion and analysis of financial condition and results of operations and elsewhere. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by us as a result of a number of important factors. Examples of these factors include (without limitation):

rapid technological developments and changes in the telecommunications industries;

our competitive environment;

changes in revenue from Universal Service Funds ( USFs );

changes in revenue resulting from regulatory actions affecting intercarrier compensation;

regulatory limitations on our ability to change our pricing for communications services;

possible widespread or lengthy failures of our system or network cables, particularly our non-redundant systems, including our primary fiber-link connecting Alaska and the lower 48-states, which would cause significant delays or interruptions of service and loss of customers;

other unanticipated damage to one or more of our high capacity cables resulting from construction or digging mishaps or natural disasters;

the possible future unavailability of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, to our wireline subsidiaries;

our ability to bundle our products and services;

changes in the demand for our products and services;

changes in general industry and market conditions and growth rates;

changes in interest rates or other general national, regional or local economic conditions;

governmental and public policy changes;

our ability to generate sufficient earnings and cash flows to continue to make dividend payments to our stockholders;

the continued availability of financing in the amounts, at the terms, and subject to the conditions necessary to support our future business;

the success of any future acquisitions;

changes in accounting policies or practices adopted voluntarily or as required by accounting principles generally accepted in the United States; and

the matters described under Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

In light of these risks, uncertainties and assumptions, you should not place undue reliance on any forward-looking statements. Additional risks that we may currently deem immaterial or that are not currently known to us could also cause the forward-looking events discussed in this Form 10-Q or our other reports not to occur as described. Except as otherwise

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required by applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Form 10-Q.

Investors should also be aware that while we do, at various times, communicate with securities analysts, it is against our policy to disclose to them any material non-public information or other confidential information. Accordingly, investors should not assume that we agree with any statement or report issued by an analyst irrespective of the content of the statement or report. To the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

## **Introduction**

As our Company and the industry have evolved members of our management have re-evaluated the way we manage our operations and how we measure success. The focus on bundling of services and the recognition that individual product lines combine to represent a cohesive package to our customers has resulted in a change in our segment reporting. These segments now focus on wireline and wireless activities as combined product offerings. The following MD&A now classifies our offerings within these segments while still providing information on how individual components of our segments contribute to the whole. This discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and the other financial information included elsewhere in this Form 10-Q.

We generate revenue primarily through:

the provision of wireline services, including:

§ local telephone services, including;

basic local service to retail customers within our service areas,

wholesale service to Competitive Local Exchange Carriers ( CLECs ),

network access services to interexchange carriers for origination and termination of interstate and intrastate long distance phone calls,

enhanced services,

ancillary services, such as billing and collection, and

universal service payments.

§ Internet services; and

§ interexchange network long-distance and data services.

the provision of wireless services.

In addition, we provide video entertainment services through our resale agreement with the satellite operator, DISH Network.

*Local Telephone* We are the largest Local Exchange Carrier ( LEC ) in Alaska. Basic local service is generally provided at a flat monthly rate and allows the user to place unlimited calls within a defined local calling area. Access revenues are generated, in part, by billing interexchange carriers for access to the LEC's local network and its customers and, in part, by billing the local customers themselves. Universal service revenues are a subsidy paid to rural LECs to support the high cost of providing service in rural markets.

Changes in revenue are largely attributable to changes in the number of access lines, local service rates and minutes of use. Other factors can also impact revenue, including:

intrastate and interstate revenue settlement methodologies;

authorized rates of return for regulated services;

whether an access line is used by a business or consumer subscriber;

intrastate and interstate calling patterns;

customers' selection of various local rate plan options;

selection of enhanced calling services, such as voice mail; and

other subscriber usage characteristics.

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LECs have three basic tiers of customers:

consumer and business customers located in our local service areas that pay for local phone service and a portion of network access;

interexchange carriers that pay for access to long distance calling customers located within our local service areas; and

CLECs that pay for wholesale access to our network in order to provide competitive local service on either a wholesale or UNE basis as prescribed under the Telecommunications Act.

LECs provide access service to numerous interexchange carriers and may also bill and collect long distance charges from interexchange carrier customers on behalf of the interexchange carriers. The amount of access charge revenue associated with a particular interexchange carrier varies depending on long distance calling patterns and the relative market share of each long distance carrier.

Our local service rates for end users are authorized by the RCA. Authorized rates are set by the FCC and the RCA for interstate and intrastate access charges, respectively, and may change from time to time.

*Internet* We are the second largest provider of Internet access services in Alaska with over 56,000 customers. We offer dial-up and dedicated digital subscriber line ( DSL ) Internet access. We are also a single source provider of advanced IP based private networks in Alaska.

*Interexchange* We provide switched and dedicated long distance services to over 64,000 customers in Alaska. The traffic from these customers is carried over our owned or leased facilities.

*Wireless* We are the second largest statewide provider of wireless services in Alaska, currently serving over 141,000 subscribers. Our wireless network footprint covers over 556,000 residents, including all major population centers and highway and ferry corridors. We offer wireless service primarily on our digital network known as code division multiple access ( CDMA ) 1xRTT, which provides customers with improved voice call quality, average mobile data speeds of 70-80kbps and a platform for the launch of enhanced services. We offer wireless broadband service based on evolution data optimized ( EV-DO ) which enables high speed data connectivity with speeds that burst up to 2mbps to our wireless markets in Anchorage, Fairbanks, Juneau and the North Slope. We also maintain a time division multiple access ( TDMA ) wireless network for our customers who have not yet upgraded to CDMA. We estimate that our CDMA service currently covers 83% of the state of Alaska's population of approximately 670,000 residents.

*Video Entertainment* We provide video entertainment services on a resale basis through our partnership with the satellite provider, DISH Network. The current agreement with the provider became effective in August 2003 and will either be renegotiated or will terminate in December 2007.

## **Critical Accounting Policies and Accounting Estimates**

Management is responsible for the financial statements herein and has evaluated the accounting policies used in their preparation. Management believes these policies to be reasonable and appropriate. Our significant accounting policies are described in Note 1, Description of Company and Summary of Significant Accounting Policies, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements. The following discussion identifies those accounting policies that management believes are critical in the preparation of our financial statements, the judgments and uncertainties affecting the application of those policies, and the possibility that materially different amounts would be reported under different conditions or using different assumptions.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Among the significant estimates affecting the financial statements are those related to the realizable value of accounts receivable, long-lived assets (in particular, those assets accounted for under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*), stock-based compensation, income taxes, network access revenue reserves and litigation reserves. Actual results may differ from those estimates.



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We use an allowance method to estimate the net realizable value of accounts receivable. As of June 30, 2007, the allowance for doubtful accounts receivable was \$8.5 million. Actual collection results could vary significantly from this estimate.

Access revenue is recognized when earned. We participate in access revenue pools with other telephone companies. Such pools are funded by toll revenue and/or access charges regulated by the RCA within the intrastate jurisdiction and the FCC within the interstate jurisdiction. Much of the interstate access revenue is initially recorded based on estimates. These estimates are derived from interim financial statements, available separations studies and the most recent information available about achieved rates of return. These estimates are subject to adjustment in future accounting periods as additional operational information becomes available. To the extent that disputes arise over revenue settlements, our policy is to defer revenue collected until settlement methodologies are resolved and finalized. At June 30, 2007, we had recorded liabilities of \$16.4 million related to our estimate of refundable access revenue. Actual results could vary from this estimate.

We use the liability method of accounting for income taxes. Under the liability method, deferred taxes reflect the temporary differences between the financial and tax bases of assets and liabilities using the enacted tax rates in effect in the years in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that it is more likely than not that such deferred tax assets will not be realized. The cumulative valuation allowance against deferred tax assets was \$112.3 million as of June 30, 2007, which represents 100% of all deferred tax assets. We will continue to assess the recoverability of deferred tax assets and the related valuation allowance. To the extent we generate taxable income in future periods, and it is determined that such valuation allowance is no longer required, the tax benefit of the remaining deferred tax assets will be recognized at such time.

Our local telephone exchange operations account for costs in accordance with the accounting principles for regulated enterprises prescribed by SFAS No. 71. This accounting recognizes the economic effects of rate regulation by recording cost and a return on investment as such amounts are recovered through rates authorized by regulatory authorities. Accordingly, under SFAS No. 71, plant and equipment is depreciated over lives approved by regulators and certain costs and obligations are deferred based upon approvals received from regulators to permit recovery of such amounts in future years.

Effective January 1, 2003, we implemented higher depreciation rates for our regulated telephone plant for the interstate jurisdiction, which we believe approximates the economically useful lives of the underlying plant. As a result, we have recorded a regulatory asset under SFAS No. 71 of \$71.3 million and \$65.7 million as of June 30, 2007 and December 31, 2006, respectively, related to depreciation of the regulated telephone plant allocable to our intrastate and local jurisdictions. If we were not following SFAS No. 71, these costs would have been charged to expense as incurred. We also have a regulatory liability of \$62.0 million and \$61.5 million at June 30, 2007 and December 31, 2006, respectively, related to accumulated removal costs on the local exchange subsidiaries. If we were not following SFAS No. 71, we would have followed SFAS No. 143 for asset retirement obligations associated with our regulated telephone plant. SFAS No. 71 also requires revenue generated between regulated and non-regulated companies not be eliminated on consolidation; these revenues totaled \$18.3 million and \$15.6 million for the six months ended June 30, 2007 and 2006, respectively. Non-regulated revenues incurred by our local telephone exchange operations and our non-regulated operations are not accounted for under SFAS No. 71 principles.

Goodwill and indefinite-lived intangible assets are assessed for impairment on at least an annual basis. SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level upon adoption and at least annually thereafter, utilizing a two-step methodology. The initial step requires us to determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of such unit. If the fair value exceeds the carrying value, no impairment loss would be recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount, if any, of the impairment is then measured in the second step. We determined the fair value of each reporting unit for purposes of this test primarily by using a discounted cash flow valuation technique. Significant estimates used in the valuation include estimates of future cash flows, both future short-term and long-term growth rates, and estimated cost of capital for purposes of arriving at a discount factor. At June 30, 2007, we had recorded goodwill of \$38.4 million applicable to our local telephone and wireless segments and intangible assets of \$21.6 million related primarily to our wireless segment, of which none was considered impaired.

As of July 1, 2005, we adopted SFAS No. 123(R), which requires us to measure compensation cost for all outstanding unvested share-based awards at fair value and recognize compensation over the service period for awards expected to vest. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results

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differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results may differ substantially from these estimates. As a result of the adoption of SFAS No. 123(R), and the issuance of restricted stock, we recorded \$1.6 million of stock-based compensation for each of the three month periods ended June 30, 2007 and 2006, respectively and \$3.3 million for each of the six month periods ended June 30, 2007 and 2006, respectively.

We are involved in various claims, legal actions, personnel matters and regulatory proceedings arising in the ordinary course of business, and have recorded litigation reserves of \$0.03 million against certain claims and legal actions as of June 30, 2007. We believe that the disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows beyond the amounts already recorded. Estimates involved in developing these litigation reserves could change as these claims, legal actions and regulatory proceedings progress.

**Employees**

As of June 30, 2007, we employed 973 regular full-time employees, 7 regular part-time employees and 10 full-time temporary employees. Of these employees, approximately 77% were represented by the International Brotherhood of Electrical Workers, Local 1547 ( IBEW ). Management considers employee relations to be good with both the represented and non-represented workforce.

**RESULTS OF OPERATIONS**

All amounts are discussed at the consolidated level after the elimination of affiliate revenue and expense.

**Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006****Operating Revenue**

Operating revenue increased \$8.2 million, or 9.6%, for the three months ended June 30, 2007 compared to the three months ended June 30, 2006. Wireline revenue increased 3.1%, while wireless revenue increased 23.7% compared to the corresponding period of 2006.

**Wireline**

The following table summarizes our consolidated wireline revenue by category:

|                        | <b>Three Months Ended<br/>June 30,<br/>2007                  2006<br/>(in thousands)</b> |           |
|------------------------|------------------------------------------------------------------------------------------|-----------|
| Local network service  | \$ 19,611                                                                                | \$ 20,159 |
| Network access         | 22,821                                                                                   | 22,093    |
| Deregulated and other  | 5,058                                                                                    | 5,234     |
| Local telephone        | 47,490                                                                                   | 47,486    |
| Internet               | 7,710                                                                                    | 6,089     |
| Interexchange          | 4,706                                                                                    | 4,550     |
| Total wireline revenue | \$ 59,906                                                                                | \$ 58,125 |

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The following table summarizes our wireline retail relationships:

|                                     | <b>As of June 30,</b> |             |
|-------------------------------------|-----------------------|-------------|
|                                     | <b>2007</b>           | <b>2006</b> |
| Local telephone                     | 191,767               | 197,031     |
| Interexchange                       | 64,684                | 60,556      |
| Internet                            | 56,638                | 54,720      |
| Total wireline retail relationships | 313,089               | 312,307     |

**Local Telephone.** Local telephone revenue, which consists of local network service, network access, and deregulated and other revenue remained flat overall for the three months ended June 30, 2007 compared to the same period in 2006. While we saw a decline in our local network service and deregulated and other revenue we had an offsetting increase in network access revenue.

Consistent with the U.S. telecommunications industry trend, we experienced a loss of local telephone access lines as customers migrated to broadband Internet services reducing demand for second lines, migrated to cable telephony, or replaced landline service with wireless service. Our primary competitor is deploying cable telephony and continues to switch its UNE-loop ( UNE-L ) provisioned subscribers over to its own network. We have seen wholesale and UNE lines decline to 46,811 on June 30, 2007, from 65,735 on June 30, 2006.

Local network service revenue decreased \$0.5 million, or 2.7%, for the three months ended June 30, 2007 compared to the three months ended June 30, 2006:

revenue from retail lines remained at \$11.4 million year over year with higher revenue per line driven by increased feature penetration, offset by a 2.7% decline in local telephone retail lines;

revenue from wholesale and UNE lines declined by \$0.6 million to \$3.9 million primarily driven by a 28.8% decline in lines offset in part increased rates; and

bad debt expense improved \$0.1 million year over year.

Network access revenue is based on a regulated return on rate base and recovery of allowable expenses associated with the origination and termination of toll calls for our retail and resale customers. Network access revenue increased \$0.7 million, or 3.3%, for the three months ended June 30, 2007, compared to the same period in 2006. The increase was driven by a positive settlement with the National Exchange Carrier Association ( NECA ) regarding our cost studies. Absent this type of settlement, network access revenue would have decreased \$1.8 million, compared to the same period in 2006. We expect that network access revenue will decline as a component of local telephone revenue for the foreseeable future due to the reduction in allowable expenses and the continued shift of voice traffic to wireless networks.

Deregulated and other revenue decreased \$0.2 million or 3.4%. The decrease is primarily the result of a decrease in deregulated customer premise equipment ( CPE ) sales of over the prior year.

**Internet.** Internet revenue increased \$1.6 million, or 26.6%, for the three months ended June 30, 2007 compared to the three months ended June 30, 2006, primarily as a result of growth in data sales to businesses and DSL subscribers, which increased 14.2% to 45,670 at June 30, 2007 from 39,982 at June 30, 2006. Also contributing to the increase was a capacity exchange agreement with another carrier resulting in approximately \$0.8 million in both revenue and COGS. These increases were partially offset by a decline in our dial up customer base.

**Interexchange.** Interexchange revenue increased \$0.2 million, or 3.4%, for the three months ended June 30, 2007, compared to the three months ended June 30, 2006. Long distance subscribers increased by 6.8% to 64,684 at June 30, 2007 from 60,556 at June 30, 2006, and non-affiliate quarterly minutes of use increased to 30.7 million for the three months ended June 30, 2007 from 30.0 million for the three months ended June 30, 2006.

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### **Wireless**

Wireless revenue increased \$6.4 million, or 23.7%, to \$33.3 million for the three months ended June 30, 2007 compared to \$26.9 million for the three months ended June 30, 2006. This increase is due primarily to the following:

growth in average subscribers of 15.0 % to 139,717 from 121,516 for the three months ended June 30, 2007 and 2006, respectively;

an increase in quarterly average revenue per unit, or ( ARPU ), of 9.0% to \$61.62 from \$56.51 for the three months ended June 30, 2007 and 2006, respectively, primarily as a result of improved subscriber mix with a higher proportion of post paid retail subscribers, increased plan revenue, feature revenue, roaming revenue, regulatory surcharges and receipt of competitive eligible telecommunications carriers ( CETC ) funding which added \$9.92 and \$9.32 to wireless ARPU in the second quarter of 2007 and 2006, respectively. Prior year ARPU was negatively impacted by \$0.8 million of revenue reserves arising from a refinement in collection estimates for a customer segment;

higher phone and accessory sales in the three months ended June 30, 2007 resulting in \$2.2 million of handset revenue compared to \$2.0 million for the three months ended June 30, 2006; and

higher revenue from non-ACS customers roaming on our network resulting in third-party roaming revenue increasing to \$4.5 million from \$3.6 million for the three months ended June 30, 2007 and 2006, respectively.

### **Operating Expense**

Operating expense increased \$5.9 million, or 8.1%, to \$78.8 million for the three months ended June 30, 2007, from \$72.9 million for the three months ended June 30, 2006. Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

#### **Wireline**

Wireline expenses, which include local telephone, Internet and interexchange, increased \$3.0 million, or 7.2%, for the three months ended June 30, 2007. The increase is primarily attributable to activity supporting our Internet service offerings including: \$0.9 million in ISP access and circuit expense, \$0.8 million of which is attributable to the capacity exchange agreement with another carrier mentioned in the revenue section above; and \$0.8 million in DSL COGS. Additionally, we saw a \$0.5 million increase in expenses associated with new CPE contracts.

#### **Wireless**

Wireless expense increased \$2.9 million, or 19.5%, for the three months ended June 30, 2007 compared to the three months ended June 30, 2006. Major components include network build-out resulting in \$2.1 million of additional expense and an increase of \$0.7 million in handset, accessory and data content expense.

**Depreciation and amortization.** Depreciation and amortization expense increased \$0.4 million, or 2.3%, for the three months ended June 30, 2007 compared to the three months ended June 30, 2006. The increase is due to an increase in depreciable base partially offset by a number of asset classes reaching their maximum depreciable lives.

**Loss on disposal of Assets.** The loss on disposal of assets decreased \$0.4 million from June 30, 2006 due to mass retirements in the prior year arising from our process improvement initiatives.

#### **Other income and expense**

Other income and expense decreased by \$8.6 million. The decrease is primarily attributable to a \$6.7 million gain in 2006 on the liquidation of the Rural Telephone Bank, as well as a \$2.0 million gain on our purchase of the Alaska terrestrial assets from Crest Communications, LLC.

#### **Income Taxes**

In the three months ended June 30, 2007 we generated taxable income which was offset by net operating loss carry forwards. We did, however, incur an alternative minimum tax charge of \$0.1 million for the same period. We have fully



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reserved the unused income tax benefit resulting from the consolidated losses we have incurred since May 14, 1999, the date of the acquisition of substantially all of our operations.

**Net income**

The decrease in net income is primarily a result of the factors discussed above.

**Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006****Operating Revenue**

Operating revenue increased \$16.1 million, or 9.6%, for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. Wireline revenue increased 2.1%, while wireless revenue increased 26.5% compared to the corresponding period in 2006.

**Wireline**

The following table summarizes our consolidated wireline revenue by category:

|                        | <b>Six Months Ended<br/>June 30,</b> |             |
|------------------------|--------------------------------------|-------------|
|                        | <b>2007</b>                          | <b>2006</b> |
|                        | <b>(in thousands)</b>                |             |
| Local network service  | \$ 39,442                            | \$ 40,056   |
| Network access         | 44,558                               | 46,119      |
| Deregulated and other  | 10,820                               | 9,586       |
| Local telephone        | 94,820                               | 95,761      |
| Internet               | 14,782                               | 12,075      |
| Interexchange          | 9,135                                | 8,423       |
| Total wireline revenue | \$ 118,737                           | \$ 116,259  |

**Local Telephone.** Local telephone revenue, which consists of local network service, network access, and deregulated and other revenue decreased \$0.9 million, or 1.0%, for the six months ended June 30, 2007 compared to the same period in 2006.

Consistent with the U.S. telecommunications industry trend, we experienced a loss of local telephone access lines as customers migrated to broadband Internet services reducing demand for second lines, migrated to cable telephony, or replaced landline service with wireless service. Our primary competitor is deploying cable telephony and continues to switch its UNE-L provisioned subscribers over to its own network. We have seen wholesale and UNE lines decline to 46,811 on June 30, 2007, from 65,735 on June 30, 2006.

Local network service revenue decreased \$0.6 million, or 1.5%, for the six months ended June 30, 2007 compared to the six months ended June 30, 2006:

revenue from retail lines increased by \$0.2 million to \$22.9 million with higher revenue per line driven by increased feature penetration and a lower level of service credits more than offsetting a 2.7% decline in local telephone retail lines;

revenue from wholesale and UNE lines declined by \$1.4 million to \$7.6 million primarily driven by a 28.8% decline in lines offset in part by favorable mix shifts and increased rates; and

bad debt expense improved \$0.7 million year over year.

Network access revenue is based on a regulated return on rate base and recovery of allowable expenses associated with the origination and termination of toll calls for our retail and resale customers. Network access revenue decreased \$1.6 million, or 3.4%, for the six months ended June 30, 2007 compared to the same period in 2006, driven in part by a



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reduction in allowable expenses and the continued shift of voice traffic to wireless networks. We expect that network access revenue will decline as a component of local telephone revenue for the foreseeable future.

Deregulated and other revenue increased \$1.2 million or 12.9%. The increase is primarily the result of an increase in CPE sales of \$0.7 million over the prior year.

**Internet.** Internet revenue increased \$2.7 million, or 22.4%, for the six months ended June 30, 2007 compared to the six months ended June 30, 2006, primarily as a result of growth in data sales to businesses and DSL subscribers, which increased 14.2% to 45,670 at June 30, 2007 from 39,982 at June 30, 2006. Also contributing to the increase was a capacity exchange agreement with another carrier resulting in approximately \$0.9 million in both revenue and COGS. This increase was partially offset by a decline in our dial up customer base.

**Interexchange.** Interexchange revenue increased \$0.7 million, or 8.5%, for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. Long distance subscribers increased by 6.8% to 64,684 at June 30, 2007, from 60,556 at June 30, 2006 and non-affiliate minutes of use increased to 60.8 million for the six months ended June 30, 2007 from 59.2 million for the six months ended June 30, 2006.

### **Wireless**

Wireless revenue increased \$13.6 million, or 26.5%, to \$65.1 million for the six months ended June 30, 2007 compared to \$51.5 million for the six months ended June 30, 2006. This increase is due primarily to the following: growth in average subscribers of 14.8% to 137,734 from 119,928 for the six months ended June 30, 2007 and 2006, respectively;

an increase in quarterly average ARPU of 7.4% to \$61.12 from \$56.90 for the six months ended June 30, 2007 and 2006, respectively, primarily as a result of improved subscriber mix with a higher proportion of post paid retail subscribers, increased plan revenue, feature revenue, roaming revenue, regulatory surcharges and receipt of CETC funding which added \$10.09 and \$9.13 to wireless ARPU for the six months ended June 30, 2007 and 2006, respectively;

higher phone and accessory sales in the six months ended June 30, 2007 resulting in \$4.4 million of handset revenue compared to \$3.6 million for the six months ended June 30, 2006; and

higher revenue from non-ACS customers roaming on our network resulting in third-party roaming revenue increasing to \$7.7 million from \$5.5 million for the six months ended June 30, 2007 and 2006, respectively.

### **Operating Expense**

Operating expense increased \$8.2 million, or 5.6%, to \$154.8 million for the six months ended June 30, 2007, from \$146.6 million for the six months ended June 30, 2006. Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

### **Wireline**

Wireline expenses, which include local telephone, Internet and interexchange increased \$4.7 million, or 5.7%, for the six months ended June 30, 2007. The increase is primarily the result of activity supporting our Internet service offerings including: \$1.0 million in ISP access and circuit expense, \$0.9 million of which is attributable to the capacity exchange agreement with another carrier mentioned in the revenue section above; and \$0.9 million in DSL COGS. Additionally, we saw a \$1.1 million increase in expenses associated with new CPE contracts in the current year, and received a \$1.0 million vendor credit in 2006 for services provided in prior years.

### **Wireless**

Wireless expense increased \$5.0 million, or 17.2%, for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. Major components include: network build-out resulting in \$3.2 million of additional expense; an increase of \$1.2 million in handset, accessory and data content expense; and an increase of \$0.3 million in advertising expense.

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**Depreciation and amortization.** Depreciation and amortization expense decreased \$0.4 million, or 1.3%, for the six months ended June 30, 2007 compared to the six months ended June 30, 2006. The decrease is primarily due to certain asset classes reaching their maximum depreciable lives.

**Loss on disposal of Assets.** The loss on disposal of assets decreased \$1.1 million from June 30, 2006 due to mass retirements in the prior year arising from our process improvement initiatives.

### **Other income and expense**

Other income and expense increased by \$1.7 million in the six months ended June 30, 2007. The increase is primarily attributable to a number of large prior year non-recurring transactions. These transactions included a \$9.7 million loss on the extinguishment of debt, offset by a \$6.7 million gain on the liquidation of the Rural Telephone Bank, and a \$2.0 million gain on the purchase of the Alaska terrestrial assets from Crest Communications, LLC.

### **Income Taxes**

In the six months ended June 30, 2007 we generated taxable income which was offset by net operating loss carry forwards. We did, however, incur an alternative minimum tax charge of \$0.1 million for the same period. We have fully reserved the unused income tax benefit resulting from the consolidated losses we have incurred since May 14, 1999, the date of the acquisition of substantially all of our operations.

### **Net income**

The increase in net income is primarily a result of the factors discussed above.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Sources**

We have satisfied our cash requirements in the first two quarters of 2007 for operations, capital expenditures and debt service primarily through internally generated funds. For the six months ended June 30, 2007, our net cash flows provided by operating activities were \$46.6 million. At June 30, 2007, we had approximately \$18.6 million in net working capital, approximately \$38.3 million in cash and cash equivalents and \$2.6 million in restricted cash. As of June 30, 2007, we had \$45.0 million of remaining capacity under our revolving credit facility, representing 100% of available capacity.

From time to time we make purchases of our outstanding debt securities on the open market or in negotiated transactions. The timing and amount of such purchases, if any, depend upon cash needs and market conditions, among other things. The 2005 senior secured credit facility contains a number of restrictive covenants and events of default, including covenants limiting capital expenditures, incurrence of debt, and payment of dividends. The 2005 senior credit facility also requires that we achieve certain financial ratios quarterly and we are currently operating comfortably within these restrictions. We have entered into a series of interest swap agreements that have effectively hedged London Inter-Bank Offered Rate ( LIBOR ) on our entire term loan.

### **Uses**

Our networks require the timely maintenance of plant and infrastructure. Our historical capital expenditures have been significant. The construction and geographic expansion of our wireless network has required significant capital. The implementation of our interexchange network and data services strategy is also capital intensive. Capital expenditures for the six months ended June 30, 2007 were \$24.4 million, inclusive of \$0.8 million of cash used to settle the net movement in balances outstanding for capital equipment received since December 31, 2006. New capital acquisition for 2007 totaled \$23.6 million of which \$5.2 million was expended on wireless capacity augmentation in the major tourist corridors where we receive a seasonal influx of visitors during the summer months. We intend to fund future capital expenditures with cash on hand, through internally generated cash flows, and if necessary, through borrowings under our revolving credit facility.

Our capital requirements may change due to impacts of regulatory decisions that affect our ability to recover our investments, changes in technology, the effects of competition, changes in our business strategy, and our decision to pursue specific acquisition and investment opportunities, among other things.

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On October 28, 2004, we announced the adoption of a dividend policy by our board of directors and declared our first quarterly dividend of \$0.185 per share. On March 21, June 14, September 16, and November 30, 2005, our board of directors declared quarterly cash dividends of \$0.20 per share. In February 2006, we announced our board of directors increased our dividend policy to an annual rate of \$0.86 per share, an increase of 7.5% over the previous annual rate of \$0.80 per share. Based on current shares outstanding at August 1, 2007 of approximately 42.8 million shares, and our current dividend of \$0.86 per share, our current annual dividend commitment is \$36.8 million. Dividends on our common stock are not cumulative.

We believe that we will have sufficient cash provided by operations and available borrowing capacity under our revolving credit facility to service our debt, pay our quarterly dividends, and fund our operations, capital expenditures and other obligations over the next 12 months. Our ability to meet such obligations will be dependent upon our future financial performance, which is, in turn, subject to future economic conditions and to financial, business, regulatory and other factors, many of which are beyond our control. In the event we pursue a strategic investment in a fiber facility as discussed under the caption **Recent Developments**, however, we may seek additional funding.

### **Outlook**

We expect that, overall, the demand for telecommunications services in Alaska will grow, particularly as a result of:

- increasing demand for wireless voice and data services following the launch of our CDMA 1xRTT network and our deployment of CDMA EV-DO services;

- growth in demand for DSL and Internet access services due to higher business and consumer bandwidth needs; and

- increasing demand for private network services by government and business customers on a statewide basis on either a circuit switched or IP basis.

We believe that we will be able to capitalize on this demand through our diverse service offerings on our owned circuit switched and IP facilities, new sales and marketing initiatives directed toward basic and enhanced voice, and data services, and our ability to provide customers an integrated bundle of telecommunication services including local telephone, wireless, Internet, long distance, messaging and video entertainment.

Consistent with the U.S. telecommunications industry, we continue to experience losses in local telephone access lines as customers cancel second lines, replace wireline services with wireless, and migrate to cable telephony. Our primary wholesale and UNE customer has announced plans to migrate most of its customers to its own cable telephony plant during the next three years. We anticipate that these trends will continue.

The telecommunications industry is extremely competitive, and we expect competition to intensify in the future. As an Incumbent LEC ( ILEC ), we face competition from resellers local providers who lease our UNEs and from providers of local telephone services over separate facilities. Moreover, we anticipate that existing and emerging wireless technologies will increasingly compete with LEC services. Similarly, we expect local and interexchange service competition will continue to come from cable television providers and voice over IP providers. In wireless services, we currently compete with at least one other wireless provider in each of our wireless service areas. In the highly competitive business for Internet access services, we currently compete with a number of established online service companies, interexchange carriers and cable companies. In the interexchange market, we face competition from two major interexchange providers and believe we currently have less than 5% of total revenue in Alaska.

The telecommunications industry is subject to continuous technological change. We expect that new technological developments in the future will generally serve to enhance our ability to provide service to our customers. However, these developments may also increase competition or require us to make significant capital investments to maintain our leadership position in Alaska.

### **Recent Developments**

On April 26, 2007, we announced an ongoing review of a strategic investment opportunity premised on the construction of a fiber facility between Alaska and the Pacific Northwest. We project that this fiber facility would be



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available commercially in early 2009. In the event we undertake this strategic investment, its success would depend on a number of factors, many of which would be outside our control.

Any estimates related to this investment are preliminary only and may not reflect the actual costs of the construction, operation, or maintenance of such a fiber facility. At this time, we have not committed to make such investment. However, on July 17, 2007 the Company retained a third-party to perform a study regarding routing of its proposed fiber optic cable system to the Pacific Northwest. The Company expects to spend approximately \$5.4 million to complete this study.

On May 1, 2007 the Federal-State Joint Board on Universal Service recommended to the FCC an interim, emergency cap on the amount of high-cost support that CETCs may receive for each state based on the average level of CETC support distributed in that state in 2006. We are waiting for FCC action on this Joint Board recommendation prior to completing our analysis of its impacts on the Company.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of June 30, 2007, we had outstanding senior unsecured notes and our 2005 senior credit facility. These on-balance sheet financial instruments, to the extent they provide for variable rates of interest, expose us to interest rate risk, with the primary interest rate risk exposure resulting from changes in LIBOR or the prime rate, which are used to determine the interest rates that are applicable to borrowings under our 2005 senior credit facility. In order to manage this risk, we have entered into a series of floating-to-fixed interest rate swap agreements that effectively fix LIBOR on the entire outstanding balance on the 2005 senior credit facility. The term of these swap agreements ranges from December 2009 through December 2011.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### *Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures, as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our disclosure controls and procedures is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

#### *Changes in Internal Control over Disclosure and Reporting*

There were no changes to the Company's internal control over financial reporting during the quarter ended June 30, 2007, that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

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

We are involved in various claims, legal actions, personnel matters and regulatory proceedings arising in the ordinary course of business. We believe that the disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

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**ITEM 1A. RISK FACTORS**

Other than as described below, there have been no material changes to the Company's risk factors as previously disclosed in Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. The risk factors described below should be read in conjunction with those disclosed in our Form 10-K.

**The announced purchase of our primary wireless competitor by AT&T, Inc., a nationwide wireless provider, could significantly change the competitive landscape in Alaska for our wireless products and services.**

On June 29, 2007, Dobson Communications Corporation (Dobson), our principal wireless competitor, entered into an Agreement and Plan of Merger with AT&T Inc. (AT&T). The companies have announced that their goal is to obtain the required approvals to consummate the transactions by the end of this year.

AT&T is the largest wireless service provider in the U.S. and Dobson is the largest wireless provider in Alaska. If AT&T becomes our principal wireless competitor in Alaska, we may face stronger competition for our wireless products and services than we have in the past. AT&T may have access to greater financial, technical and other resources than we do. Further, AT&T may have greater access to consumer devices, and greater market power to obtain these devices on more favorable terms, than we do. AT&T, thus, might be able to offer lower prices, additional products, services, features, or other incentives that we cannot match or offer. Further, AT&T may be in a position to respond more quickly to new technologies and be able to undertake more extensive marketing campaigns.

Moreover, AT&T operates its own nationwide network, whereas we rely on roaming agreements with other carriers to provide coverage outside Alaska. Our reliance on these agreements could adversely affect our ability to maintain competitive pricing, which would have a material adverse effect on our financial results. If its purchase of Dobson is consummated, AT&T will initially have a larger installed client base in Alaska than we do. This added competitive pressure from the existence of a large national provider could have a material adverse effect on our business, operating results, and financial condition.

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

**Working capital restrictions and other limitations on the payment of dividends**

Our 2005 senior secured credit facility contains a number of restrictive covenants and events of default, including covenants limiting capital expenditures, incurrence of debt, and the payment of dividends. Such credit facility also requires that we maintain certain financial ratios.

In addition, our board of directors may, in its absolute discretion, amend or repeal our dividend policy which may result in the decrease or discontinuation of dividends. Future dividends, if any, will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions, business opportunities, any competitive or technological developments, our increased need to make capital expenditures, provisions of Delaware law or other applicable law, and other factors that our board of directors may deem relevant.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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We held our Annual Meeting of Shareholders on June 18, 2007. The following matters were considered:

All board nominees were elected as directors with the following vote:

| Nominee              | For        | Withheld |
|----------------------|------------|----------|
| Liane J. Pelletier   | 36,774,259 | 894,325  |
| Brian D. Rogers      | 37,414,566 | 254,018  |
| John M. Egan         | 37,418,660 | 249,924  |
| Patrick Pichette     | 37,514,359 | 154,225  |
| Gary R. Donahee      | 37,411,473 | 257,111  |
| Edward J. Hayes, Jr. | 37,520,583 | 148,001  |
| Annette M. Jacobs    | 37,515,284 | 153,300  |
| David A. Southwell   | 37,524,120 | 144,464  |

KPMG LLP was ratified as the independent public accountant and auditor for the fiscal year ending December 31, 2007 with the following vote:

| For        | Against | Withheld |
|------------|---------|----------|
| 37,540,592 | 91,658  | 36,334   |

The number of shares of our common stock reserved for future issuance under the Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan was increased by 1,500,000 shares with the following vote:

| For        | Against    | Withheld | Broker non-votes |
|------------|------------|----------|------------------|
| 18,026,142 | 10,762,791 | 93,232   | 8,786,420        |

The material terms of senior officers' performance goals to qualify certain compensation as performance-based, as described in the proxy statement, was approved with the following vote:

| For        | Against   | Withheld | Broker non-votes |
|------------|-----------|----------|------------------|
| 23,133,503 | 5,658,829 | 89,834   | 8,786,417        |

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS****(a) Exhibits:**

- 10.1 Form of Restricted Stock Agreement between the Registrant and certain participants in the Registrants 1999 Stock Incentive Plan
- 31.1 Certification of Liane Pelletier, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of David Wilson, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Liane Pelletier, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of David Wilson, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 2, 2007

**ALASKA COMMUNICATIONS SYSTEMS  
GROUP, INC.**

/s/ Liane Pelletier

Liane Pelletier  
Chief Executive Officer,  
Chairman of the Board and  
President

/s/ David Wilson

David Wilson  
Senior Vice President and  
Chief Financial Officer  
(Principal Accounting Officer)