

ALASKA COMMUNICATIONS SYSTEMS GROUP INC

Form 10-K/A

November 03, 2005

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
(Amendment No. 1)**

(Mark One)

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

For the fiscal year ended December 31, 2004

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE 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

(Address of principal executive offices)

99503-6091

(Zip Code)

(907) 297-3000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

None

Securities registered pursuant to Section 12(g) of the Act:

Title of each class

Common Stock, Par Value \$.01 per Share

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark if whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act.) Yes No

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

The aggregate market value of the shares of all classes of voting stock of the registrant held by non-affiliates of the registrant on June 30, 2004, was approximately \$58,072,215 computed upon the basis of the closing sales price of the Common Stock on that date. For purposes of this computation, shares held by directors (and shares held by any entities in which they serve as officers) and officers of the registrant have been excluded. Such exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of October 31, 2005, there were outstanding 41,531,147 shares of Common Stock, \$.01 par value, of the registrant.

Documents Incorporated by Reference

None

Table of Contents

EXPLANATORY NOTE:

Alaska Communications Systems Group, Inc. (the Company) and its consolidated subsidiaries is filing this Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission on March 9, 2005, to reflect a correction in the balance sheet classification of auction-rate securities and short-term investments from cash and cash equivalents to a separate line item within current assets, and to reflect purchases and sales of auction-rate securities and short-term investments as investing cash flows in the statements of cash flows; and a reclassification of cash used to reacquire stock from a retired officer as a financing activity rather than an operating activity in the Statements of Cash Flows within Part II Items 6 and 7, and Part IV Item 15. See Note 25 of the Notes to Consolidated Financial Statements for further detail. Also included in Part IV Item 15, is a restatement of our stock option pro forma net loss and earnings per share disclosure. This disclosure is being restated to correct errors found in our calculation of the pro forma effects of accounting for stock options in accordance with Statement of Financial Accounting Standards No. 148. Subsequent to the filing of our Annual Report on Form 10-K for the year ended December 31, 2004, like many other companies that invest in auction-rate securities, Alaska Communications Systems Group, Inc. has determined, based upon supplemental accounting interpretation and in consultation with our audit committee, that our investments in auction-rate securities should not have been included in cash and cash equivalents, as had been done historically by the Company in our financial statements. We invest in auction-rate securities as part of our cash management strategy and have historically classified them as cash and cash equivalents because of the short duration of their reset periods. As a result of this change in classification, our cash flows from investing activities now include purchases and sales of auction-rate securities. This change in classification has no impact on previously reported total current assets, total assets, working capital position, results of operations or financial covenants and does not affect previously reported cash flows from operating or financing activities. Also subsequent to the filing of our Annual Report on Form 10-K for the year ended December 31, 2004, we identified an error in the cash flow presentation regarding the reacquisition of Company stock owned by a retired officer. We corrected this error in the Statements of Cash Flows by reclassifying the cash used as a financing activity rather than an operating activity. Also subsequent to the filing of our Annual Report on Form 10-K for the year ended December 31, 2004, we began to reassess our stock compensation plan models in anticipation of adopting SFAS 123R *Share-Based Payment*, in 2005. During that reassessment we identified certain computational errors and errors related to our stock option valuation model assumptions. The primary causes of this restatement related to the assumptions regarding the treatment of forfeitures and the period over which the compensation cost should be recorded. See Note 1 of the Notes to Consolidated Financial Statements for further detail. Except for the aforementioned changes, this Form 10-K/A does not modify or update other disclosures in the Form 10-K, including the nature and character of such disclosure to reflect events occurring after the initial filing date of the Form 10-K.

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC .
AMENDMENT NO. 1
ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2004
Table of Contents**

	Page
<u>Part II</u>	
<u>Item 6.</u> <u>Selected Financial Data</u>	4
<u>Item 7.</u> <u>Management s Discussion and Analysis of Financial Condition and Results of Operations</u>	5
Table of Contents	4

PART IV

<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	20
------------------------	--	-----------

	<u>Signatures</u>	21
--	--------------------------	-----------

<u>Index to Consolidated Financial Statements</u>	F-1
--	------------

EXHIBIT 31.1

EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

Table of Contents**PART II****Item 6. Selected Financial Data****SELECTED HISTORICAL FINANCIAL DATA**

The following selected financial data in this amended report has been restated for the years ended December 31, 2004, 2003 and 2002 to reflect purchases and sales of auction-rate securities and other short-term investments as investing cash flows and certain payments to an affiliate as financing cash flows (see Note 25 to Consolidated Financial Statements). The following table sets forth our historical consolidated financial data as of December 31, 2004, 2003, 2002, 2001 and 2000 and for the fiscal years ended December 31, 2004, 2003, 2002, 2001 and 2000, which are derived from our audited financial statements for those years.

The selected historical financial data set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with Management's discussion and analysis of financial condition and results of operations and our consolidated financial statements and related notes thereto for the years ended December 31, 2004, 2003, 2002, 2001 and 2000.

(\$ in thousands)	2004	2003	2002	2001	2000
Operating Data:					
Operating revenues	\$ 302,707	\$ 323,847	\$ 340,394	\$ 328,525	\$ 311,366
Operating expenses before					
loss(gain) on disposal of assets	289,735	361,074	360,995	281,402	277,598
Loss (gain) on disposal of assets	2,854	(112,622)	2,163		
Operating income (loss)	10,118	75,395	(22,764)	47,123	33,768
Other expense	(49,647)	(81,661)	(49,501)	(56,907)	(57,950)
Loss before income taxes, discontinued operations, extraordinary item and cumulative effect of change in accounting principle	(39,529)	(6,266)	(72,265)	(9,784)	(24,182)
Income tax benefit (expense)	219	(1,095)		195	197
Equity in income of investments	16	783		69	(303)
Loss from continuing operations	(39,294)	(6,578)	(72,265)	(9,520)	(24,288)
Loss from discontinued operations		(52)	(7,632)	(1,718)	(917)
Loss before cumulative effect of change in accounting principle	(39,294)	(6,630)	(79,897)	(11,238)	(25,205)
Cumulative effect of change in accounting principle			(105,350)		
Net loss	\$ (39,294)	\$ (6,630)	\$ (185,247)	\$ (11,238)	\$ (25,205)
Loss per share basic and diluted:					
Loss from continuing operations	\$ (1.33)	\$ (0.22)	\$ (2.30)	\$ (0.30)	\$ (0.74)
Loss from discontinued operations			(0.24)	(0.06)	(0.03)
Cumulative effect of change in accounting principle			(3.35)		

Edgar Filing: ALASKA COMMUNICATIONS SYSTEMS GROUP INC - Form 10-K/A

Net loss	\$ (1.33)	\$ (0.22)	\$ (5.89)	\$ (0.36)	\$ (0.77)
Weighted average shares outstanding (000 s):					
Basic	29,592	29,980	31,464	31,523	32,654
Diluted	29,592	29,980	31,464	31,523	32,654

Balance Sheet Data (end of period):

Total assets	\$ 637,127	\$ 685,391	\$ 752,509	\$ 949,095	\$ 953,660
Long-term debt, including current portion	525,889	550,220	607,763	611,250	614,004
Stockholders' equity (deficit)	(33,442)	1,860	8	191,687	215,380

Other Financial Data:

Cash provided by operating activities	\$ 59,025	\$ 50,411	\$ 65,984	\$ 76,679	\$ 49,589
Cash provided (used) by investing activities	(44,455)	64,295	(70,028)	(95,899)(1)	(75,795)(1)
Cash used by financing activities	(18,486)	(77,695)	(8,703)	(1,664)	(13,892)
Capital expenditures	51,422	50,906	72,621	88,998	73,349

(1) Cash provided (used) by investing activities for the years ended December 31, 2001 and 2000 has not been restated for the effects of the Company's treatment of auction-rate securities and other short-term investments discussed in Note 25 to the Company's consolidated financial statements as it was not practicable for the Company to obtain such information.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following 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-K/A.

Alaska Communications Systems Group

We generate revenue primarily through:

The provision of local telephone services, including:

Basic local service to retail customers within our service areas,

Wholesale service to Competitive Local Exchange Carriers, or 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;

The provision of wireless services;

The provision of Internet services; and

The provision of interexchange network long-distance and data services.

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

Local Telephone We are the largest Local Exchange Carrier (LEC) in Alaska and the 13th largest in the United States. 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.

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 Unbundled Network Element (UNE) basis as prescribed under the Telecommunications Act.

Table of Contents

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 upon 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 Regulatory Commission of Alaska, or RCA. Authorized rates are set by the Federal Communications Commission, or FCC, and the RCA for interstate and intrastate access charges, respectively, and may change from time to time.

Wireless - We are the second largest statewide provider of wireless services in Alaska, currently serving over 100,000 subscribers. Our wireless network footprint covers over 482,000 residents, including all major population centers and highway and ferry corridors. We currently operate a TDMA digital network in substantially all of our service areas, and are rolling out a new generation of digital network known as CDMA 1xRTT, which provides customers with improved voice call quality, average mobile data speeds of 70-80kbps and provides a platform for the launch of enhanced services. We began offering CDMA 1xRTT services in several of our service areas in May 2004. In June 2004 we began offering wireless broadband service based on EV-DO which enables high speed data connectivity with speeds that burst up to 2mbps to our wireless markets in Anchorage, Fairbanks, and Juneau. We estimate that the new CDMA service currently covers 73% of our wireless footprint of 482,000 residents.

Internet - We are the second largest provider of Internet access services in Alaska with over 47,000 customers. We offer dial-up and dedicated DSL Internet access to our customers. We are a single source provider of advanced IP based private networks in Alaska.

Interexchange - We provide switched and dedicated long distance services to over 47,000 customers in Alaska. The traffic from these customers is carried over our owned or leased facilities.

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 August 2003 and will either be renegotiated or terminate in December 2005.

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), income taxes, network access revenue reserves and litigation reserves. Actual results may differ from those estimates.

We use an allowance method to estimate the net realizable value of accounts receivable. As of December 31, 2004, the allowance for doubtful accounts receivable was \$4.9 million. Actual collection results could vary significantly from management's estimate.

Table of Contents

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 December 31, 2004, we had recorded liabilities of \$18.6 million related to our estimate of refundable access revenue. Actual results could vary from this estimate.

We utilize 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 \$112.2 million as of December 31, 2004, which represents 100% of all deferred tax assets.

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.

We implemented, effective January 1, 2003, higher depreciation rates for our regulated telephone plant for the interstate jurisdiction which management believes approximate the economically useful lives of the underlying plant. As a result, we have recorded a regulatory asset under SFAS No. 71 of \$35.0 million as of December 31, 2004 related to depreciation of the regulated telephone plant allocable to its intrastate and local jurisdictions. We have also deferred as a regulatory asset \$0.9 million of costs incurred in connection with regulatory rate making proceedings, which is being amortized over three years starting in 2003. The balance of this regulatory asset was \$0.3 million at December 31, 2004. If we were not following SFAS No. 71, we would have recorded additional cumulative depreciation expense of \$35.0 million for the intrastate and local jurisdictions and the deferred costs incurred in connection with regulatory rate making proceedings would have been charged to expense as incurred. We also have a regulatory liability of \$54.3 million at December 31, 2004 related to accumulated removal costs. If we were not following SFAS No. 71, we would have followed SFAS No. 143 for asset retirement obligations. Non-regulated revenues and costs incurred by the local telephone exchange operations and our non-regulated operations are not accounted for under SFAS No. 71 principles.

Effective January 1, 2002, we adopted SFAS No. 142, Goodwill and Other Intangible Assets. In accordance with the guidelines of this accounting principle, goodwill and indefinite-lived intangible assets are no longer amortized but will be 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 December 31, 2004, we had recorded goodwill of \$38.4 million applicable to our local telephone and wireless segments and intangible assets of \$21.9 million related primarily to our wireless segment.

We are involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business, and have recorded litigation reserves of \$4.2 million against certain claims and legal actions as of

December 31, 2004. 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 are resolved.

Table of Contents**Results of Operations**

The following table summarizes our company's operations for the years ended December 31, 2004, 2003, and 2002. Certain reclassifications have been made to 2003 and 2002 to conform to the current presentation of our consolidated operations.

(\$ in thousands, except per share data)	2004	2003	2002
Operating revenues:			
Local telephone	\$ 211,187	\$ 215,686	\$ 226,697
Wireless	56,694	46,548	43,180
Directory		11,631	33,604
Internet	20,173	33,026	20,847
Interexchange	14,653	16,956	16,066
Total operating revenues	302,707	323,847	340,394
Operating expenses:			
Local telephone (exclusive of depreciation and amortization)	127,918	116,653	114,832
Wireless (exclusive of depreciation and amortization)	37,918	31,064	29,352
Directory (exclusive of depreciation and amortization)		5,249	14,170
Internet (exclusive of depreciation and amortization)	25,739	45,523	31,299
Interexchange (exclusive of depreciation and amortization)	19,773	25,542	23,647
Contract termination and asset impairment charges		54,858	
Depreciation and amortization	78,387	82,185	82,940
Loss (gain) on disposal of assets, net	2,854	(112,622)	2,163
Goodwill impairment loss			64,755
Total operating expenses	292,589	248,452	363,158
Operating income (loss)	10,118	75,395	(22,764)
Other income and expense:			
Interest expense	(51,288)	(71,470)	(51,704)
Interest income and other	1,641	(10,191)	2,203
Total other income (expense)	(49,647)	(81,661)	(49,501)
Loss before income taxes, discontinued operations and cumulative effect of change in accounting principle	(39,529)	(6,266)	(72,265)
Income tax (expense) benefit	219	(1,095)	
Equity in income of investments	16	783	
Loss from continuing operations	(39,294)	(6,578)	(72,265)
Loss from discontinued operations		(52)	(7,632)
Loss before cumulative effect of change in accounting principle	(39,294)	(6,630)	(79,897)
Cumulative effect of change in accounting principle			(105,350)

Net loss	\$ (39,294)	\$ (6,630)	\$ (185,247)
Loss per share basic and diluted:			
Loss from continuing operations	\$ (1.33)	\$ (0.22)	\$ (2.30)
Loss from discontinued operations			(0.24)
Cumulative effect of change in accounting principle			(3.35)
Net loss	\$ (1.33)	\$ (0.22)	\$ (5.89)
Weighted average shares outstanding:			
Basic	29,592	29,980	31,464
Diluted	29,592	29,980	31,464

Table of Contents**Year Ended December 31, 2004 Compared to Year Ended December 31, 2003****Operating revenues**

Operating revenue decreased \$21.1 million, or 6.5%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. Wireless revenue increased compared to the corresponding period of 2003, while local telephone, Internet and interexchange revenue decreased compared to the corresponding period of 2003. On May 8, 2003, we completed the sale of a majority interest (87.42%) in our Directories Business and on August 27, 2003, we sold the majority of our remaining interest and now own less than 0.1% of the Directories Business. We did not have any operating revenues from the Directories Business after May 8, 2003, but had recorded \$11.6 million of revenues from this business for the year ended December 31, 2003.

On September 15, 2003, we received notification from the State of Alaska that they intended to terminate our five year Telecommunications Services Partnering Agreement (TPA). Subsequently, we negotiated and agreed to a definitive Settlement Agreement and Mutual Release effective October 14, 2003, outlining the terms of disentanglement. Operating revenue in 2003 included \$19.9 million of revenue from the TPA contract that was nonrecurring in 2004.

Local Telephone. Local telephone revenue, which consists of local network service, network access and deregulated and other revenue, decreased \$4.5 million, or 2.1%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. The following table summarizes our consolidated local telephone revenue by category:

	Year Ended December 31,	
	2004	2003
	(in thousands)	
Local telephone revenue:		
Local network service	\$ 91,669	\$ 96,357
Network access revenue	97,536	97,759
Deregulated revenue and other	21,982	21,570
Total local telephone revenue	\$ 211,187	\$ 215,686

The following table summarizes our local telephone access lines:

	As of December 31,	
	2004	2003
Retail access lines	207,905	218,058
Wholesale access lines	16,590	19,159
Unbundled network elements loop (UNE-L)	64,589	68,916
Unbundled network elements platform (UNE-P)	6,365	5,333
Total local telephone access lines	295,449	311,466

Consistent with the U.S. telecommunications industry trend, we experienced a loss of network 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. Additionally, our primary competitor has begun to deploy cable telephony and began switching its UNE-L provisioned subscribers over to its own network in the Anchorage market during 2004. In November 2004 we received a final order from the RCA with respect to UNE-L rates for ACSA, retroactive to June 2004 increasing the UNE-L rate from \$14.92 to \$18.64. See Item 1. Business Regulation for further discussion.

Local network service revenue decreased \$4.7 million, or 4.9%, for the year ended December 31, 2004, compared to the year ended December 31, 2003, while access lines in service decreased 5.1% to 295,449. The decrease in

revenue primarily reflects the net effect of retail access line losses representing a revenue reduction of approximately \$7.3 million offset by increases in UNE rates and average UNEs in service representing a revenue increase of approximately \$2.1 million.

Table of Contents

Network access revenue decreased \$0.2 million, or 0.2%, for the year ended December 31, 2004 compared to the same period in 2003. The decrease in network access revenue reflects the loss of retail access lines, offset by increases in special access revenue and ongoing true-ups to prior years interstate access and universal service fund studies. 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. Management expects that network access revenue will decline as a component of local telephone revenue for the foreseeable future.

Deregulated and other revenue, which increased \$0.4 million, or 1.9%, for the year ended December 31, 2004, compared to the year ended December 31, 2003, consists principally of billing and collection services, space and power rents, deregulated equipment sales, paystation revenue, regulated directory listing revenue, and other miscellaneous telephone revenue.

Wireless. Wireless revenue increased \$10.1 million, or 21.8%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. This increase is due primarily to the following:

growth in average subscribers of 10.4% for the year ended December 31, 2004 over the prior year period;

an increase in monthly average revenue per unit, or ARPU, of 8.6% to \$44.64 for the year ended December 31, 2004, from \$41.09 for the year ended December 31, 2003, primarily as a result of increased plan revenue, roaming, and regulatory surcharges; and

higher gross customer adds in the year ended December 31, 2004 resulting in \$4.3 million of handset revenue compared to \$2.3 million for the year ended December 31, 2003.

Internet. Internet revenue decreased \$12.9 million, or 38.9%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. This decrease is primarily due to the loss of \$15.5 million in revenue associated with the State of Alaska TPA, which was terminated in October 2003, offset by approximately \$2.6 million of revenue increases primarily as a result of growth in DSL subscribers of 39.0% to 24,711 at December 31, 2004, from 17,784 at December 31, 2003.

Interexchange. Interexchange revenue decreased \$2.3 million, or 13.6%, for the year ended December 31, 2004, compared to the year ended December 31, 2003. The decline was primarily due to the termination of services to the State of Alaska TPA, which accounted for \$4.4 million in 2003 revenue, offset by an increase in long distance subscribers of 3,884, or 9.0%, from 43,166 in 2003 to 47,050 in 2004. Total minutes of use decreased to 136.7 million for the year ended December 31, 2004, from 149.3 million for the year ended December 31, 2003.

Operating expenses

Operating expenses increased \$44.1 million, or 17.7%, from \$248.5 million for the year ended December 31, 2003 to \$292.6 million for the year ended December 31, 2004. Included in operating expenses for 2003 is approximately \$25.7 million of expenses attributable to the State of Alaska TPA, contract termination and asset impairment charges of \$54.9 million, and a net gain on disposal of assets of \$112.6 million.

On May 8, 2003, we completed the sale of a majority interest (87.42%) in its Directories Business. We did not have any expenses from operations from the Directories Business after this date.

Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

Local Telephone. The components of local telephone expense are plant specific operations, plant non-specific operations, customer operations, corporate operations and property and other operating tax expense. Local telephone expense increased from \$116.7 million for the year ended December 31, 2003 to \$127.9 million for the year ended December 31, 2004, an increase of \$11.2 million or 9.6%. The increase in local telephone expense was substantially attributable to \$6.6 million of organizational restructuring costs (including \$2.5 million of consulting, \$1.0 million of hiring, recruiting and severance costs, and \$3.1 million of early lease termination expense), \$2.5 million of inventory write-downs,

Table of Contents

and \$1.5 million of other unusual charges. We also implemented a contractual wage increase for our represented employees of approximately 2.3% on January 1, 2004.

Wireless. Wireless expense increased \$6.9 million, or 22.1%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. This increase is due primarily to a \$3.0 million increase in the cost of equipment associated with customer acquisition as we experienced 33,476 gross customer additions during 2004 compared to 23,220 in the prior year, an increase in leased circuit and outside services costs increase of \$3.1 million associated with our CDMA deployment during 2004, and additional roaming expense.

Internet. Internet expenses decreased by \$19.8 million, or 43.5%. The decrease in Internet expense was due principally to the termination of the State of Alaska TPA, which had incurred \$20.4 million of expense during 2003 with no corresponding TPA expense in 2004. The elimination of expenses associated with the TPA was partially offset by additional expenses associated with a 39.0% increase in DSL subscribers over the prior year.

Interexchange. Interexchange expenses decreased by \$5.8 million, or 22.6%. \$5.2 million of this decrease was attributable to costs associated with the State of Alaska TPA, which was terminated during the fourth quarter of 2003. Additionally, minutes of use decreased 8.4% to 136.7 million for the year ended December 31, 2004, from 149.3 million for the year ended December 31, 2003.

Contract termination and asset impairment charges. During the year ended December 31, 2003, we recorded \$54.9 million in contract termination and asset impairment charges for which no corresponding charges were incurred during 2004. These charges resulted from (1) the termination of the TPA with the State of Alaska and (2) an impairment of fiber optic indefeasible rights of use and IP network and service center assets resulting from the termination of the TPA as well as changes in the communications industry and the economy.

The following table itemizes the components of the contract termination and asset impairment charges (in thousands).

Contract termination charges:	
Contract termination cash settlement	\$ 3,448
Loss on disposal of assets	5,648
Accounts receivable and working capital write-downs	3,575
 Total contract termination charges	 \$ 12,671
 Asset impairment charges	 \$ 42,187
 Total contract termination and asset impairment charges	 \$ 54,858

See Note 9 Contract Termination and Asset Impairment Charges, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, for a description of each element of the contract termination and asset impairment charges.

Depreciation and amortization. Depreciation and amortization expense decreased \$3.8 million, or 4.6%, primarily as a result of a decline in net property, plant and equipment of 5.9% from \$438.1 million at December 31, 2003 to \$412.3 million at December 31, 2004. Much of the decline in net property, plant and equipment resulted from the loss on disposal and asset impairment charges incurred during the third quarter of 2003, as described above.

Loss (Gain) on disposal of assets. On April 28, 2003, we entered into an underwriting agreement to sell a majority interest in our Directories Business and on April 29, 2003 filed a final prospectus to offer this majority interest to investors through a Canadian income fund. The transaction was completed on May 8, 2003, with us selling an 87.42% interest and retaining a 12.58% interest in our Directories Business. We recognized a gain on disposition of this majority interest of our Directories Business of \$97.6 million on a pre-tax basis during 2003.

Subsequently on August 27, 2003, we disposed of substantially all of our remaining interest through the exercise of our right to convert 99.23% of our then remaining 12.58% interest to 2.5 million units of the ACS Media Income Fund, which were then sold in an underwritten offering. The transaction settled on September 4, 2003, generating

\$17.2 million in net

Table of Contents

proceeds and a gain on disposition of \$15.9 million. As a result of this transaction, we now own less than 0.1% of the Directories Business.

We recorded a non-cash loss on the disposal of certain fixed assets of \$2.9 million during 2004 compared to \$0.9 million during 2003, exclusive of the gain on the sale of our Directories Business.

Interest expense and interest income and other

Interest expense decreased \$20.2 million, or 28.2%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. As a result of the early extinguishments of outstanding debt of \$106.7 million during the second quarter of 2003 and the refinancing of \$320.7 million during the third quarter of 2003, \$13.1 million of debt issuance cost was charged to interest expense. We also extinguished early our interest rate swap contract during the fourth quarter of 2003. This swap contract accounted for \$15.6 million of 2003 interest expense. These reductions to 2004 interest expense were partially offset by higher interest associated with our 9 7/8% senior unsecured notes due 2011, which were in effect for the full year of 2004 compared to approximately one quarter during 2003, and higher variable interest rates on principal outstanding under our senior bank credit facilities experienced during 2004 compared to 2003.

Interest income and other increased from a net expense of \$10.2 million for 2003 to income of \$1.6 million for 2004, or a positive year-over-year variance of \$11.8 million, due substantially to a \$15.9 million non-operating impairment loss on a note receivable offset by the \$4.3 million gain on foreign exchange on the sale of the Directories Business, both of which were recorded during 2003.

Income taxes

We have fully reserved the 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. During 2004, we received a refund of prior year estimated alternative minimum taxes of \$0.2 million.

Loss from discontinued operations

During 2003, we completed a plan we adopted on March 3, 2002 to dispose of our former wireless television segment, which resulted in a loss on disposal of \$0.1 million for 2003.

Net loss

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

Year ended December 31, 2003 compared to year ended December 31, 2002

Operating revenues

Operating revenues decreased \$16.6 million, or 4.9%, for the year ended December 31, 2003 compared to the year ended December 31, 2002. Wireless, Internet, and interexchange revenues increased compared to the prior period, while local telephone decreased. On May 8, 2003, we completed the sale of a majority interest (87.42%) in our Directories Business and sold substantially all remaining interest in August 2003. We did not have any operating revenues from the Directories Business after May 8, 2003.

Local telephone. Local telephone revenues, which consist of local network service, network access revenue, and deregulated revenues and other, decreased \$11.1 million, or 4.9%, for the year ended December 31, 2003 compared to the same period in 2002.

Table of Contents

The following table summarizes our consolidated local telephone revenue by category:

	Year Ended December 31,	
	2003	2002
	(in thousands)	
Local telephone revenue:		
Local network service	\$ 96,357	\$ 99,512
Network access revenue	97,759	108,335
Deregulated revenue and other	21,570	18,850
Total local telephone revenue	\$ 215,686	\$ 226,697

The following table summarizes our local telephone access lines:

	As of December 31,	
	2003	2002
Retail access lines	218,058	236,148
Wholesale access lines	19,159	22,148
Unbundled network elements loop (UNE-L)	68,916	62,091
Unbundled network elements platform (UNE-P)	5,333	2,620
Total local telephone access lines	311,466	323,007

The local network service component of local telephone revenues was \$96.3 million during 2003 compared with \$99.5 million during 2002. Local network service revenue decreased \$3.2 million or 3.2% from the prior year, while average access lines in service decreased 3.6% to 318,614. Substantially all of the decrease reflects the net effect of retail market share losses offset by increases in unbundled network element revenue. Retail access lines decreased 18,090 or 7.7% to 218,058 at December 31, 2003. Approximately 2,800 of the decrease in retail access lines was due to a change in the counting methodology adopted for 2003 and later periods to exclude company use of our access lines.

We experienced a loss of direct retail customers during the year as customers cancelled second lines they were not using or switched to competing service providers. This reduction in direct retail customers was partially offset by an increase in wholesale lines. Generally, if a retail local network service customer of ours switches to a competitor, we continue to provide the line to the competitor on a wholesale basis at reduced revenue per line. Management believes that the continuing loss of market share we have experienced in certain of our markets is partially attributable to below cost interconnection rates mandated by the RCA for UNEs. On October 25, 2001, the RCA granted ACSA an interim UNE rate increase of \$1.07, bringing the UNE rate up from \$13.85 to \$14.92. The interim and refundable rate increase was implemented in November 2001 and generated approximately \$0.8 million in additional revenue during 2003. See Item 1. Business Regulation for further discussion.

Network access revenues decreased by \$10.6 million, or 9.8%, from \$108.3 million in 2002 to \$97.8 million in 2003. During the second quarter of 2002, we recognized as revenue \$11.1 million of previously deferred interstate access revenue related to a dispute on interstate access rates for the Anchorage market based on a favorable ruling by the District of Columbia Court of Appeals. Network access revenue is based on a regulated return on rate base and recovery of allowable expense associated with the origination and termination of toll calls for our retail and resale customers. Excluding the impact of the revenue recognized as a result of the favorable ruling by the court, the increase in network access revenues of \$0.5 million compared to the corresponding period in 2002 is due primarily to updated access studies. Management expects that network access revenues will generally be on a declining trend for the foreseeable future.

Deregulated and other revenues, which increased \$2.7 million, or 14.4% from 2002, consists principally of billing and collection services, space and power rents, deregulated equipment sales, pay station revenues, regulated directory listing revenue, and other miscellaneous telephone revenues. The increase in deregulated and other revenue was due primarily to an increase in rents and billing and collection revenue.

Table of Contents

Wireless. Wireless revenues increased \$3.4 million, or 7.8%, to \$46.5 million for the year ended December 31, 2003 compared to \$43.2 million for the year ended December 31, 2002. This increase is due primarily to growth in average subscribers of 4.2% from 81,170 in 2002 to 84,619 in 2003. Subscriber average monthly minutes of use increased from 202 minutes in 2002 to 227 minutes in 2003. Primarily as a result of increased minutes of use over plan allotments, the monthly average revenue per unit, or ARPU, increased from \$44.33 in 2002 to \$45.84 in 2003.

Internet. Internet revenues increased from \$20.8 million in 2002 to \$33.0 million in 2003 an increase of \$12.2 million, or 58.4%. This increase is primarily due to revenue associated with our contract with the State of Alaska and because approximately \$1.2 million of this increase was earned in the prior year but could not be estimated and therefore was not recorded until the current year. Internet also experienced growth in DSL subscribers of 41.2% from 12,590 at December 31, 2002 to 17,780 at December 31, 2003.

On September 15, 2003, we received notification from the State of Alaska that it intended to terminate a five year TPA with us and disentangle. Subsequently, we negotiated with the State and agreed to a definitive Settlement Agreement and Mutual Release effective October 14, 2003, outlining the terms of disentanglement between the parties. State of Alaska contract revenues included in Internet were \$15.5 million and \$8.0 million for the years ended December 31, 2003 and 2002, respectively.

Interexchange. Interexchange revenue increased from \$16.1 million in 2002 to \$17.0 million in 2003 an increase of \$0.9 million, or 5.5%. Long distance subscribers decreased from approximately 70,000 at December 31, 2002 to 43,166 at December 31, 2003. The decrease in subscribers was substantially due to database grooming to remove approximately 20,000 non-revenue generating inactive subscribers from the subscriber list in connection with the conversion of long distance billing from an outside service bureau to an in-house system during the first and second quarters of 2003. The average revenue per unit, or ARPU, increased to \$24.97 in 2003 compared to \$19.73 during 2002 and total minutes of use decreased from 153.4 million in 2002 to 149.3 million in 2003. The decline in minutes of use was due to increased competition in the marketplace, and the popularity of discount long distance calling cards. Currently, we have a low penetration on this product, but we expect our market share to grow as we increasingly offer attractive bundles to our customers, which may offset declines in interexchange revenue due to the termination of the State of Alaska contract.

Operating expenses

Operating expenses decreased \$114.7 million, or 31.6%, from \$363.2 million for the year ended December 31, 2002 to \$248.5 million for the year ended December 31, 2003. Included in operating expenses for 2003 is a net gain on disposal of assets of \$112.6 million and contract termination and asset impairment charges of \$54.9 million. Included in operating expenses for 2002 is a goodwill impairment charge of \$64.8 million and a net loss on disposal of assets of \$2.2 million. Excluding these charges, operating expenses increased \$10.0 million or 3.4%.

On May 8, 2003, we completed the sale of a majority interest (87.42%) in our Directories Business. We did not have any expenses from operations from the Directories Business after this date.

Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

Local telephone. The components of local telephone expense are plant specific operations, plant non-specific operations, customer operations, corporate operations and property and other operating tax expense. Local telephone expense increased from \$114.8 million for the year ended December 31, 2002 to \$116.7 million for the year ended December 31, 2003 an increase of \$1.9 million or 1.7%. The increase in local telephone expense was substantially attributable to executive recruiting and retirement costs, litigation reserves and federal universal service charges recorded during the third and fourth quarters of 2003.

Wireless. Wireless expense increased \$1.7 million, or 5.8%, for the year ended December 31, 2003 compared to the year ended December 31, 2002. This increase is substantially due to an increase of minutes of use from 196.8 million in 2002 to 231.0 million in 2003.

Table of Contents

Internet. Internet expenses increased by \$14.2 million, or 45.4%. The increase in Internet expense was due principally to transition expenses and operating costs associated with providing services under the State of Alaska telecommunications contract. State of Alaska contract related expense totaling \$1.5 million was incurred in the previous year but was recorded in the current year as it was the first point in which the expense could be matched to the associated revenue, as discussed above in Internet revenue. We negotiated with the State and agreed to a definitive Settlement Agreement and Mutual Release effective October 14, 2003, terminating the contract and outlining the terms of disentanglement between the parties. We anticipate expense for this segment to decline as we complete the disentanglement under the contract.

Interexchange. Interexchange expenses increased by \$1.9 million, or 8.0%. The majority of this increase was caused by an increase in billing and collection fees, toll switching and litigation reserves in 2003.

Contract termination and asset impairment charges. During the year ended December 31, 2003, we recorded \$54.9 million in contract termination and asset impairment charges. These charges resulted from (1) the termination of the TPA with the State of Alaska and (2) an impairment of fiber optic indefeasible rights of use and IP network and service center assets resulting from the termination of the TPA as well as changes in the communications industry and the economy.

The following table itemizes the components of the contract termination and asset impairment charges (in thousands).

Contract termination charges:	
Contract termination cash settlement	\$ 3,448
Loss on disposal of assets	5,648
Accounts receivable and working capital write-downs	3,575
Total contract termination charges	\$ 12,671
Asset impairment charges	\$ 42,187
Total contract termination and asset impairment charges	\$ 54,858

See Note 9 Contract Termination and Asset Impairment Charges, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, for a description of each element of the contract termination and asset impairment charges.

Depreciation and amortization. Depreciation and amortization expense decreased \$0.8 million, or 0.9%.

Loss (gain) on disposal of assets. On April 28, 2003, we entered into an underwriting agreement to sell a majority interest in our Directories Business and on April 29, 2003 we filed a final prospectus to offer this majority interest to investors through a Canadian income fund. The transaction was completed on May 8, 2003, with us selling an 87.42% interest and retaining a 12.58% interest in our Directories Business. We recognized a gain on disposition of this majority interest of our Directories Business of \$97.6 million on a pre-tax basis.

Subsequently on August 27, 2003, we disposed of substantially all of our remaining interest through the exercise of our right to convert 99.23% of our then remaining 12.58% interest to 2.5 million units of the ACS Media Income Fund, which were then sold in an underwritten offering. The transaction settled on September 4, 2003, generating \$17.2 million in net proceeds and a gain on disposition of \$15.9 million. As a result of this transaction, we now own less than 0.1% of the Directories Business.

We recorded a non-cash loss on the disposal of certain fixed assets of \$0.9 million during 2003 and \$2.2 million during 2002.

Goodwill impairment loss. We recorded a non-cash goodwill impairment charge during the fourth quarter of 2002 of \$64.8 million as a result of our annual goodwill impairment test under SFAS No. 142, Goodwill and Intangible Assets. See Note 4, Goodwill and Other Intangible Assets, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, for additional information.

Table of Contents

Interest expense and interest income and other

Interest expense increased \$19.8 million, or 38.2%, for the year ended December 31, 2003 compared to the year ended December 31, 2002. As a result of the early extinguishments of outstanding debt of \$106.7 million during the second quarter of 2003 and the refinancing of \$320.7 million during the third quarter of 2003, \$13.1 million of debt issuance cost was charged to interest expense. We also extinguished early our interest rate swap contract during the fourth quarter of 2003, resulting in a charge of \$8.0 million which resulted in \$5.1 million of interest expense in excess of what would have been recorded had the swap not been terminated. During the second quarter of 2002, we reversed \$1.7 million of previously accrued interest expense as a result of a favorable ruling by the District of Columbia Court of Appeals related to a dispute on interstate access rates for the Anchorage market. In addition, we incurred additional interest expense in 2003 under our \$182 million 9 % senior notes due 2011, offset by lower term loan balances and the results of market interest rate effects on our variable interest rate debt.

Interest income and other (including equity in income of investments) also declined by \$12.4 million, primarily due to a \$15.9 million non-operating impairment loss on a note receivable offset by the \$4.3 million gain on foreign exchange on the sale of the Directories Business.

Income taxes

We have fully reserved the 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. During 2003, we incurred \$1.1 million in Alternative Minimum Tax as a result of the sale of our Directories Business.

Discontinued operations

On March 30, 2002, our management approved a plan to offer for sale our wireless cable television service segment. As a result of this decision, the operating revenue and expense of this segment has been classified as discontinued operations under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, for all periods presented and the assets and liabilities of the disposal group have been written down to their fair value, net of expected selling expense. The write down and results of operations of this discontinued segment resulted in a charge to discontinued operations of \$52,000 and \$7.6 million for the years ended December 31, 2003 and 2002, respectively. We have fully reserved in the form of a valuation allowance the income tax benefit of this discontinuance. We completed our disposal of our wireless cable television segment as of March 31, 2003.

Cumulative effect of change in accounting principle

During the second quarter of fiscal 2002, we also completed the transitional review for goodwill impairment required under SFAS No. 142, Goodwill and Intangible Assets. This review indicated that goodwill recorded in the local telephone, Internet and interexchange segments was impaired as of January 1, 2002. Accordingly, we measured and recognized a transitional impairment loss of \$105.4 million as a cumulative effect of a change in accounting principle. See Note 4, Goodwill and Other Intangible Assets, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, for additional discussion of the impact of this statement on our consolidated financial statements.

Net loss

Net loss decreased \$178.6 million, or 96.4% for the year ended December 31, 2003, compared to the year ended December 31, 2002, as a result of the factors discussed above.

Liquidity and capital resources

We have satisfied our cash requirements for operations, capital expenditures and debt service primarily through internally generated funds, the sale of stock and debt financing. For the year ended December 31, 2004, our cash flows from operating activities were \$59.0 million. At December 31, 2004, we had approximately \$71.2 million in net working capital, with approximately \$50.7 million represented by cash and cash equivalents, \$35.2 million by short term investments and \$4.7 million by restricted cash. As of December 31, 2004, we had \$50.0 million of remaining capacity under our former revolving credit facility, representing 100% of available capacity.

Table of Contents

As of December 31, 2004, we had outstanding a \$198.0 million under a bank credit agreement, our 2003 senior secured credit facility, \$147.5 million in senior subordinated notes due 2009 and \$177.7 million in senior unsecured notes, representing substantially all of our long-term debt of \$525.9 million. On May 14, 2004, we called \$17.3 million of our 13% senior discount debentures due 2011. The redemption was completed on June 14, 2004 at 106.5% of the outstanding principal and as a result a call premium of \$1.1 million was paid. Our board of directors authorized us to buy back up to \$10 million of our outstanding debt in the open market during the three months ended December 31, 2004. During the quarter ended December 31, 2004, we repurchased \$4.4 million aggregate principal amount of senior unsecured notes and \$2.5 million of senior subordinated notes in the open market. From time to time we consider making purchases of our outstanding debt securities on the open market or in negotiated transactions. The timing and amount of such purchases, if any, will depend upon cash needs and market conditions, among other things. Interest on the senior subordinated notes and senior unsecured notes is payable semiannually. Interest on borrowings under the 2003 senior credit facility is payable monthly, bi-monthly, quarterly or semi-annually at our option. The 2003 senior credit facility requires \$0.5 million quarterly principal payments that commenced on March 31, 2004, with the balance due in 2010. The 2003 senior secured credit facility, the senior subordinated notes and the senior unsecured notes contain a number of restrictive covenants and events of default, including covenants limiting capital expenditures, incurrence of debt, and the payment of dividends, and the 2003 senior credit facility requires us to achieve certain financial ratios. We are in compliance with all of our debt covenants as of December 31, 2004.

In February and March 2005, we completed refinancing transactions whereby we entered into a new \$380 million senior secured credit facility, the 2005 senior credit facility, and used the \$335.0 million of term loan borrowings under that facility, together with the \$84.1 million in gross proceeds of a simultaneous offering of our common stock and cash on hand to:

repay in full and redeem the \$198.0 of outstanding principal under our 2003 senior credit facility, together with interest accrued thereon;

repurchase \$59.3 million of outstanding principal of our senior unsecured notes, together with tender premiums and interest accrued thereon;

repurchase \$140.1 million of outstanding principal of our senior subordinated notes, together with tender premiums and interest accrued thereon;

call for redemption the \$7.4 million of remaining principal of senior subordinated notes; and

pay underwriters' discounts and transaction fees and expenses associated with the equity offering and refinancing transactions.

These transactions resulted in total long-term obligations outstanding of approximately \$458 million as of March 3, 2005, consisting primarily of the \$380.0 million 2005 senior credit facility with a drawn term loan of \$335.0 million and an undrawn revolving credit facility of \$45.0 million, and \$118.3 million remaining aggregate principal amount outstanding of senior unsecured notes. The \$335.0 million term loan under the 2005 senior credit facility was drawn on February 1, 2005 and generally bears interest at an annual rate of LIBOR plus 2.00%, with a term of seven years from the date of closing and no scheduled principal payments before maturity. The \$45.0 million undrawn revolving credit facility, to the extent drawn in the future, will bear interest at an annual rate of LIBOR plus 2.00% and have a term of six years from the date of closing. To the extent the \$45.0 million revolving credit facility under the 2005 senior credit facility remains undrawn, we will pay an annual commitment fee of 0.375% of the undrawn principal amount over its term. We also entered into floating-to-fixed interest rate swaps with a total notional amount of approximately \$135.0 million that swap the floating interest rate on a portion of the term loan borrowings under the 2005 senior credit facility for a fixed rate of 4.13% per year. Three-month LIBOR was approximately 2.64% on February 1, 2005. See Note 23, Subsequent Events, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, for additional information about the equity offering and refinancing transactions.

On July 15, 2002, we fulfilled a commitment to Crest to provide a loan for the aggregate principal amount of \$15 million in return for certain consideration. We have an agreement that enables us to purchase additional fiber optic capacity in future years from Crest, the expenditures for which are expected to be significant and may exceed \$20 million over the next two years. We purchased additional capacity under this agreement for \$5.6 million during 2004. While we have an agreement with Crest, certain material terms of the agreement remain subject to continued renegotiation. The significant provisions of this agreement are: (i) purchase commitments by us for capacity in 2005 and 2006, the final price and quantity of which are subject to future events, (ii) Crest's restoration of our traffic carried on another cable system and (iii) specific interconnection arrangements between us and Crest, should we exercise our option to purchase certain network assets from Crest. We are currently renegotiating open elements of our agreement with Crest. It is impossible to determine the ultimate outcome of these negotiations at this time. The loan was written down to zero, its estimated fair value, during September 2003.

Table of Contents

The following summarizes our contractual obligations and commitments with quantifiable payment terms as of December 31, 2004:

	Total	2005	2006-2007	2008-2009	Thereafter
Long-term debt	\$ 517,829	\$ 1,413	\$ 2,620	\$ 149,805	\$ 363,991
Capital leases	8,060	885	1,984	1,603	3,588
Operating leases	6,779	2,194	2,389	1,470	726
Unconditional purchase obligations	10,942	6,357	3,565	1,020	
Total contractual cash obligations	\$ 543,610	\$ 10,849	\$ 10,558	\$ 153,898	\$ 368,305

We also have obligations for material cash interest payments on our long-term debt that are not included in the table above. Approximately 36% of our debt at December 31, 2004 is subject variable interest rates. See Item 7a. Quantitative and qualitative disclosure about market risk for more information.

The local telephone network requires 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 2004 were \$51.4 million, of which \$10.4 million was expended on CDMA 1xRTT build out and \$5.6 million was expended on the Crest fiber optic capacity purchases. 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. At December 31, 2004 we had allocated \$55.0 million of our total current unrestricted cash and short term investment balance of \$85.9 million to fund the completion over the next two years of our CDMA 1xRTT and EV-DO build out and to secure fiber capacity within Alaska and to the lower 48 states in the United States under the terms of our agreement with Crest.

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 opportunities, among other things.

We announced on October 28, 2004 the adoption of a dividend policy by our board of directors and declared our first quarterly dividend of \$0.185 per share, payable on January 19, 2005 to holders of record on December 31, 2004. While we intend to continue to pay quarterly dividends, such payment is subject to our future operating and financial performance, capital expenditures, working capital requirements and other factors. Accordingly, our board of directors may modify or revoke this policy at any time. See Item 5. Market for Registrant's Common Equity and Related Stockholder Matters Dividends. Simultaneous with the announcement of the dividend policy, we also announced the withdrawal of our registration statements for a proposed initial public offering of income deposit securities, a separate proposed offering of senior subordinated notes and the proposed reclassification of our existing common stock into cash and shares of new class B common stock which we had filed with the SEC. No securities were sold under the withdrawn registration statements.

Subsequent to December 31, 2004, we issued 8.8 million shares of our common stock in an equity offering that closed on February 1, 2005 and, through the partial exercise by the underwriters of their over-allotment option, an additional 1.1 million shares that closed on March 2, 2005. As a result of these issuances, we have outstanding 40.6 million shares as of March 2, 2005. The issuance of these additional shares of our common stock will increase our aggregate annual dividend payments by approximately \$7.3 million to approximately \$30.0 million annually based on our current dividend policy of \$0.74 per share per year. See Note 23, Subsequent Events, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, for additional information about the offering of our common stock.

We believe that we will have sufficient working capital provided by operations and available borrowing capacity under our revolving credit facility to service our debt, pay our quarterly dividends, 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.

Table of Contents

Effect of new accounting standards

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities – An Interpretation of Accounting Research Bulletin (ARB) No. 51. In December 2003, the FASB issued FIN 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46R). FIN 46R provides guidance on how to identify variable interest entities and how to determine whether or not those entities should be consolidated. We were required to apply FIN 46R by the end of the first reporting period after March 15, 2004, for entities which were created before February 1, 2003. The adoption of FIN 46R was immediate for variable interest entities created after January 31, 2003. We have evaluated the provisions of FIN 46R and determined that we do not have any variable interest entities that require consolidation in our financial statements.

In December 2004, the FASB issued SFAS No. 123(Revised), Share-Based Payment. This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires companies to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees and to record compensation cost for all stock awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. In addition, we are required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. SFAS 123(R) will be effective for our third quarter ending September 30, 2005. We have not yet determined the impact that SFAS 123(R) will have on our financial position and results of operations, but expect that the stock incentive plans disclosure provided in Note 1,

Description of Company and Summary of Significant Accounting Policies, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements, provides a reasonable measure of the expected annual impact.

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;

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 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 voice, enhanced and data services, and offering 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 experienced a loss in network access lines during the year as customers cancelled second lines, replaced wireline services with wireless, and lines migrated to cable telephony. Our primary UNE customer has announced plans to migrate most of its Anchorage area customers to its own cable telephony plant during the next three years. Consequently, we anticipate that these trends will continue.

There are currently a number of regulatory proceedings underway at the state and federal levels that could have a significant impact on our operations. We cannot predict with certainty the impact of current or future regulatory developments on any of our businesses.

The telecommunications industry is extremely competitive, and we expect competition to intensify in the future. As an ILEC, we face competition mainly from resellers, local providers who lease our UNEs and from providers of local telephone services over separate facilities. Moreover, while wireless telephone services have historically complemented traditional LEC services, we anticipate that existing and emerging wireless technologies may increasingly compete with LEC services. Similarly, local and interexchange service competition may 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 believe we currently have less than 5% of total revenue in Alaska and face competition from two major interexchange providers.

Table of Contents

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.

Impact of inflation

The effect of inflation on our financial results has not been significant in the periods presented.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) 1. *Financial Statements*

Our consolidated financial statements are submitted as a separate section of this Form 10-K/A. See Index to Consolidated Financial Statements and Schedule which appears on page F-1 hereof.

2. *Financial Statement Schedule*

Our financial statement schedules for the Company and its subsidiaries are submitted as a separate section of this Form 10-K/A. See Index to Consolidated Financial Statements and Schedule which appears on page F-1 hereof.

Exhibit

No.	Description
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 Executive 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.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or Section 15(d) of the Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 2, 2005

Alaska Communications Systems Group, Inc.

By: /s/ Liane Pelletier
 Liane Pelletier
 Chief Executive Officer, Chairman of
 the Board and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/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)	
/s/ Kenneth L. Sprain Kenneth L. Sprain	Senior Vice President, Network and IT Operations	
/s/ David C. Eisenberg David C. Eisenberg	Senior Vice President, Corporate Strategy and Development	
/s/ Sheldon Fisher Sheldon Fisher	Senior Vice President, Sales and Product Marketing	
/s/ Leonard A. Steinberg Leonard A. Steinberg	Vice President, General Counsel and Corporate Secretary	
/s/ Elizabeth A. Pierce Elizabeth A. Pierce	Vice President, Human Resources and Facilities Services	
/s/ Byron I. Mallott Byron I. Mallott	Director	
/s/ Brian Rogers Brian Rogers	Director	

Brian Rogers

/s/ W. Dexter Paine, III Director

W. Dexter Paine, III

/s/ John M. Egan Director

John M. Egan

/s/ Patrick Pichette Director

Patrick Pichette

/s/ Gary R. Donahee Director

Gary R. Donahee

/s/ John W. Gibson Director

John W. Gibson

Table of Contents

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE**

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets December 31, 2004 (as restated) and 2003 (as restated)</u>	F-3
<u>Consolidated Statements of Operations Years Ended December 31, 2004, 2003 and 2002</u>	F-4
<u>Consolidated Statements of Stockholders Equity (Deficit) and Comprehensive Income (Loss) Years Ended December 31, 2004, 2003 and 2002</u>	F-5
<u>Consolidated Statements of Cash Flows Years Ended December 31, 2004 (as restated), 2003 (as restated) and 2002 (as restated)</u>	F-6
<u>Notes to Consolidated Financial Statements Years Ended December 31, 2004, 2003 and 2002</u>	F-7
<u>Schedule II Valuation and Qualifying Accounts</u>	F-49

F-1

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Alaska Communications Systems Group, Inc.

Anchorage, Alaska

We have audited the consolidated balance sheets of Alaska Communications Systems Group, Inc. and Subsidiaries (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity (deficit) and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal controls over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Alaska Communications Systems Group, Inc. and Subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 4 to the consolidated financial statements, effective January 1, 2002 the Company adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*.

As discussed in Note 25, the accompanying consolidated financial statements have been restated.

/s/ DELOITTE & TOUCHE LLP

Portland, Oregon

March 7, 2005

(November 2, 2005 as to Note 25)

F-2

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Balance Sheets
December 31, 2004 and 2003
(In Thousands, Except Per Share Amounts)

Assets	As Restated 2004	See Note 25 2003
Current assets:		
Cash and cash equivalents	\$ 50,660	\$ 54,576
Restricted cash	4,690	3,635
Short term investments	35,200	43,222
Accounts receivable-trade, net of allowance of \$4,869 and \$4,865	39,413	41,718
Materials and supplies	6,623	10,099
Prepayments and other current assets	3,724	5,850
 Total current assets	 140,310	 159,100
Property, plant and equipment	1,061,767	1,041,904
Less: Accumulated depreciation and amortization	649,455	603,760
 Property, plant and equipment, net	 412,312	 438,144
Goodwill	38,403	38,403
Intangible Assets	21,871	22,055
Debt issuance costs	15,482	18,939
Deferred charges and other assets	8,749	8,750
 Total assets	 \$ 637,127	 \$ 685,391
	Liabilities and Stockholders	Equity (Deficit)
Current liabilities:		
Current portion of long-term obligations	\$ 2,298	\$ 1,982
Accounts payable-affiliate	3,973	5,082
Accounts payable, accrued and other current liabilities	53,843	47,303
Income taxes payable	8,948	1,095
Advance billings and customer deposits	8,948	8,766
 Total current liabilities	 69,062	 64,228
Long-term obligations, net of current portion	523,591	548,238
Other deferred credits and long-term liabilities	77,916	71,065
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred stock, no par, 5,000 authorized, no shares issued and outstanding		
Common stock, \$.01 par value; 145,000 shares authorized, 35,245 and 33,611 shares issued and 30,695 and 29,343 outstanding, respectively	352	336
		(1,198)

Common stock, \$.01 par value; 0 and 267 shares subject to mandatory redemption		
Treasury stock, 4,549 and 4,268 shares, respectively, at cost	(18,443)	(17,118)
Paid in capital in excess of par value	282,272	278,181
Accumulated deficit	(293,092)	(253,798)
Accumulated other comprehensive loss	(4,531)	(4,543)
Total stockholders' equity (deficit)	(33,442)	1,860
Total liabilities and stockholders' equity (deficit)	\$ 637,127	\$ 685,391

See Notes to Consolidated Financial Statements

F-3

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Operations
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

	2004	2003	2002
Operating revenues:			
Local telephone	\$ 211,187	\$ 215,686	\$ 226,697
Wireless	56,694	46,548	43,180
Directory		11,631	33,604
Internet	20,173	33,026	20,847
Interexchange	14,653	16,956	16,066
Total operating revenues	302,707	323,847	340,394
Operating expenses:			
Local telephone (exclusive of depreciation and amortization)	127,918	116,653	114,832
Wireless (exclusive of depreciation and amortization)	37,918	31,064	29,352
Directory (exclusive of depreciation and amortization)		5,249	14,170
Internet (exclusive of depreciation and amortization)	25,739	45,523	31,299
Interexchange (exclusive of depreciation and amortization)	19,773	25,542	23,647
Contract termination and asset impairment charges		54,858	
Depreciation and amortization	78,387	82,185	82,940
Loss (gain) on disposal of assets, net	2,854	(112,622)	2,163
Goodwill impairment loss			64,755
Total operating expenses	292,589	248,452	363,158
Operating income (loss)	10,118	75,395	(22,764)
Other income and expense:			
Interest expense	(51,288)	(71,470)	(51,704)
Interest income and other	1,641	(10,191)	2,203
Total other income (expense)	(49,647)	(81,661)	(49,501)
Loss before income taxes, discontinued operations and cumulative effect of change in accounting principle	(39,529)	(6,266)	(72,265)
Income tax (expense) benefit	219	(1,095)	
Equity in income of investments	16	783	
Loss from continuing operations	(39,294)	(6,578)	(72,265)
Loss from discontinued operations		(52)	(7,632)

Edgar Filing: ALASKA COMMUNICATIONS SYSTEMS GROUP INC - Form 10-K/A

Loss before cumulative effect of change in accounting principle	(39,294)	(6,630)	(79,897)
Cumulative effect of change in accounting principle			(105,350)
Net loss	\$ (39,294)	\$ (6,630)	\$ (185,247)
Loss per share basic and diluted:			
Loss from continuing operations	\$ (1.33)	\$ (0.22)	\$ (2.30)
Loss from discontinued operations			(0.24)
Cumulative effect of change in accounting principle			(3.35)
Net loss	\$ (1.33)	\$ (0.22)	\$ (5.89)
Weighted average shares outstanding:			
Basic	29,592	29,980	31,464
Diluted	29,592	29,980	31,464

See Notes to Consolidated Financial Statements

F-4

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Stockholders Equity (Deficit)
and Comprehensive Income (Loss)
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

	Common Stock	Shares Subject to Mandatory Redemption	Treasury Stock	Paid in Capital in Excess of Par	Accumulated Equity Deficit	Accumulated Other Comprehensive Loss	Stockholders Equity (Deficit)
Balance, January 1, 2002	\$ 332	\$	\$ (9,735)	\$ 276,840	\$ (61,921)	\$ (13,829)	\$ 191,687
Components of comprehensive loss:							
Net loss					(185,247)		(185,247)
Minimum pension liability adjustment						(2,342)	(2,342)
Interest rate swap marked to market						(2,715)	(2,715)
Total comprehensive loss							(190,304)
Issuance of 260 shares of common stock, \$.01 par	2			970			972
Purchase of 1,205 shares of treasury stock			(2,347)				(2,347)
Balance, December 31, 2002	334		(12,082)	277,810	(247,168)	(18,886)	8
Components of comprehensive income:							
Net loss					(6,630)		(6,630)
Minimum pension liability adjustment						191	191
Interest rate swap marked to market						14,152	14,152
Total comprehensive							7,713

income

Issuance of 130 shares of common stock, \$.01 par	2			265			267
Grant of 200 shares from treasury stock			794	106			900
Purchase of 1,732 shares of treasury stock			(5,830)				(5,830)
267 shares subject to mandatory redemption		(1,198)					(1,198)
Balance, December 31, 2003	336	(1,198)	(17,118)	278,181	(253,798)	(4,543)	1,860
Components of comprehensive loss:							
Net loss					(39,294)		(39,294)
Minimum pension liability adjustment						12	12
Total comprehensive loss							(39,282)
Purchase of 267 shares subject to mandatory redemption		1,198	(1,262)				(64)
Purchase of 14 shares of treasury stock, \$.01 par			(63)				(63)
Dividends declared				(5,694)			(5,694)
Issuance of 1,634 shares of common stock, \$.01 par	16			9,785			9,801
Balance December 31, 2004	\$ 352	\$	\$ (18,443)	\$ 282,272	\$ (293,092)	\$ (4,531)	\$ (33,442)

See Notes to Consolidated Financial Statements

F-5

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Cash Flows
Years Ended December 31, 2004, 2003 and 2002
(In Thousands)

	As Restated - See note 25		
	2004	2003	2002
Cash Flows from Operating Activities:			
Net loss	\$ (39,294)	\$ (6,630)	\$ (185,247)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Loss on discontinued operations		52	7,632
Cumulative effect of change in accounting principle			105,350
Depreciation and amortization	78,387	82,185	82,940
Loss (gain) on disposal of assets and asset impairment charges, net	2,854	(48,863)	2,163
Goodwill impairment loss			64,755
Amortization of debt issuance costs, original issue discount and warrants	6,088	17,048	4,524
Non-cash stock based compensation expense		900	
Other non-cash expenses	12	4,118	
Other deferred credits	3,048	1,643	3,073
Changes in components of working capital:			
Accounts receivable and other current assets	7,907	7,451	(4,722)
Accounts payable and other current liabilities	22	(6,380)	(12,460)
Other	1	(1,072)	(1,375)
Net cash used in discontinued operations		(41)	(649)
Net cash provided by operating activities	59,025	50,411	65,984
Cash Flows from Investing Activities:			
Construction and capital expenditures	(51,422)	(48,566)	(68,434)
Purchase of short term investments	(154,650)	(100,053)	(32,400)
Proceeds from sale of short term investments	162,672	57,831	42,100
Net proceeds from sale of business unit		155,269	
Release of funds from escrow		3,539	3,706
Placement of funds in escrow	(1,055)	(3,725)	
Issuance of note receivable			(15,000)
Net cash provided (used) by investing activities	(44,455)	64,295	(70,028)
Cash Flows from Financing Activities:			
Payments on long-term debt	(26,962)	(434,102)	(7,328)
Proceeds from issuance of long-term debt		375,970	
Debt issuance costs		(14,000)	
Issuance of common stock	9,801	267	972
Purchase of treasury stock	(1,325)	(5,830)	(2,347)
Net cash used by financing activities	(18,486)	(77,695)	(8,703)
Increase (decrease) in cash	(3,916)	37,011	(12,747)
Cash and cash equivalents at beginning of the year	54,576	17,565	30,312
Cash and cash equivalents at the end of the year	\$ 50,660	\$ 54,576	\$ 17,565

Supplemental Cash Flow Data:

Interest paid, net of capitalized interest	\$ 45,470	\$ 51,372	\$ 46,930
Income taxes paid, net of refund	876		
Supplemental Noncash Transactions:			
Property acquired under capital leases and mortgages	\$	\$ 2,340	\$ 4,187
Minimum pension liability adjustment	(12)	(191)	2,342
Interest rate swap marked to market		(14,152)	2,715
Dividend declared	(5,694)		

See Notes to Consolidated Financial Statements

F-6

Table of Contents

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)**

1. DESCRIPTION OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Alaska Communications Systems Group, Inc. and Subsidiaries (the Company or ACS Group), a Delaware corporation, is engaged principally in providing local telephone, wireless, Internet, interexchange network and other services to its retail consumer and business customers and wholesale customers in the State of Alaska through its telecommunications subsidiaries. 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 are as of December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 and 2002 and represent the consolidated financial position, results of operations and cash flows principally of ACS Group and the following wholly owned subsidiaries:

Alaska Communications Systems Holdings, Inc. (ACS Holdings)

ACS of Alaska, Inc. (ACSAK)

ACS of the Northland, Inc. (ACSN)

ACS of Fairbanks, Inc. (ACSF)

ACS of Anchorage, Inc. (ACSA)

ACS Wireless, Inc. (ACSW)

ACS Long Distance, Inc. (ACSLD)

ACS Internet, Inc. (ACSI)

On May 8, 2003, the Company completed the sale of a majority interest (87.42%) in the newly formed ACS Media LLC (the Directories Business). Subsequently, on August 27, 2003, the Company disposed of substantially all of its remaining interest in the Directories Business. As a result of this transaction, the Company now owns less than 0.1% of the Directories Business. See Note 10, Gain on Disposal of Assets, for additional information on this transaction.

A summary of significant accounting policies followed by the Company is set forth below:

Basis of Presentation

The consolidated financial statements include all majority-owned subsidiaries. All significant intercompany balances have been eliminated. Certain reclassifications have been made to the 2003 and 2002 financial statements to make them conform to the current presentation.

Use of Estimates

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 contingent assets and liabilities 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, materials and supplies, long-lived assets, income taxes and network access revenue reserves. Actual results may differ from those estimates.

Cash and Cash Equivalents

For purposes of the consolidated balance sheets and statements of cash flows, the Company generally considers all highly liquid investments with a maturity at acquisition of three months or less to be cash equivalents.

Table of Contents

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Restricted Cash

The Company has placed restricted cash in certificate of deposits as required under the terms of certain contracts to which it is a party. When the restrictions are lifted, the Company will transfer the funds back into its operating accounts.

Materials and Supplies

Materials and supplies are carried in inventory at the lower of weighted average cost or market.

Short-term Investments

Short-term investments include investments in auction-rate securities. Short-term investments are considered available for sale and are carried at amortized cost which approximates fair value.

Property, Plant and Equipment

Telephone plant is stated substantially at original cost of construction. Telephone plant retired in the ordinary course of business, together with the cost of removal, less salvage, is charged to accumulated depreciation with no gain or loss recognized. Renewals and betterments of telephone plant are capitalized while repairs, as well as renewals of minor items, are charged to operating expense as incurred. The Company provides for depreciation of telephone plant on the straight-line method, using rates approved by regulatory authorities. The composite annualized rate of depreciation for all classes of telephone property, plant, and equipment was 6.1%, 7.0%, and 7.4% for 2004, 2003 and 2002, respectively.

Non-Telephone plant is stated at purchased cost and, when sold or retired, a gain or loss is recognized. Depreciation of such property is provided on the straight-line method over its estimated service life ranging from three to 20 years.

The Company is the lessee of equipment and buildings under capital leases expiring in various years through 2019. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the assets. The assets are amortized over the lower of their related lease terms or the estimated productive lives. Amortization of assets under capital leases is included in depreciation and amortization expense for 2004, 2003 and 2002.

Debt Issuance Costs

Underwriting, legal, accounting, printing, and other fees and expenses associated with the issuance of the Company's senior credit facility, senior subordinated notes, senior unsecured notes and senior discount debentures are being amortized using the straight-line method which approximates the effective interest method, over the term of the debt. During 2004, the Company extinguished early its 13% senior discount debentures which resulted in a write off to expense of \$330 of debt issuance costs. During 2003, the Company extinguished early its old bank credit facility which resulted in a write off to expense of \$13,052 of debt issuance costs. Debt issuance costs amortization and write offs included in interest expense for 2004, 2003 and 2002 was \$3,457, \$16,591, and \$4,239, respectively.

Original Issue Discounts

Certain debt instruments of the Company have been issued below their face value, resulting in original issue discounts that are recorded net in long-term debt. These original issue discounts are amortized using the effective interest method. During 2004, the Company extinguished early its 13% senior discount debentures which resulted in a write off to expense of \$1,968 of original issue discount. Original issue discount amortization and write offs included in interest expense for 2004, 2003 and 2002 was \$2,631, \$457, and \$285, respectively.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Treasury Stock

The Company was authorized by its Board of Directors in November 2003 to repurchase up to \$10,000 of its common stock. ACS Group acquired 119 shares of its common stock for \$535 under this authorization, which expired on December 31, 2004. During 2002, the Company was authorized by its Board of Directors to repurchase up to \$15,000 of its common stock. ACS Group acquired 2,832 shares of its common shares for \$7,705 under this authorization, which expired in November 2003. The treasury stock acquired under these authorizations is being held for general corporate purposes. The Company funded the grant of 200 shares of stock to an officer of the Company using treasury stock in October 2003.

Revenue Recognition

Substantially all recurring service revenues are billed one month in advance and are deferred until earned. Nonrecurring and usage sensitive revenues are billed in arrears and are recognized when earned. Additionally, the Company establishes estimated bad debt reserves against uncollectible revenues incurred during the period. During 2004, 2003 and 2002, one customer accounted for 12%, 10% and 11%, respectively, of consolidated revenues, and no other customer accounted for more than 10% of consolidated revenue.

In October and November 2001, under two separate regulatory orders, ACSA was authorized to implement interim and refundable rate increases for both loop rental rates on unbundled network elements and for local service revenue. The Company recognized \$3,753 and \$4,940 of revenue during 2003 and 2002, respectively, associated with these rate increase authorizations. Interim and refundable local service rates were made permanent by a Regulatory Commission of Alaska (RCA) order during 2004 and, as a result, there is no longer a refund obligation associated with these rates. Additionally, final Anchorage loop rates were implemented during 2004 that are in excess of the interim and refundable loop rates approved during 2001, making any future refund obligation unlikely.

Access revenue is recognized when earned. The Company participates in toll 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 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. During the second quarter of 2002, the Company recognized as revenue \$11,066 of previously deferred interstate access revenue and reversed \$1,673 of interest expense previously accrued thereon as a result of a favorable ruling by the District of Columbia Court of Appeals related to a dispute on interstate access rates for the Anchorage market. At December 31, 2004 and 2003, the Company had recorded liabilities totaling \$18,557 and \$15,211, respectively, related to its estimate of refundable access revenue.

Income Taxes

The Company utilizes 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 management believes it is more likely than not that such deferred tax assets will not be realized.

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.

F-9

Table of Contents

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

Regulatory Accounting and Regulation (Continued)

The Company implemented, effective January 1, 2003, 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 \$34,972 and \$17,231 as of December 31, 2004 and 2003, respectively, related to depreciation of the regulated telephone plant allocable to its intrastate and local jurisdictions. The Company has also deferred as a regulatory asset \$894 of costs incurred in connection with regulatory rate making proceedings, which is being amortized over three years starting in 2003. The remaining balance of this regulatory asset was \$298 at December 31, 2004. If the Company were not following SFAS No. 71, these costs would have been charged to expense as incurred. The Company also has a regulatory liability of \$54,349 and \$50,546 at December 31, 2004 and 2003, respectively, related to accumulated removal costs. If the Company were not following SFAS No. 71, it would have followed SFAS No. 143 for asset retirement obligations associated with its regulated telephone plant. Non-regulated revenues and costs incurred by the local telephone exchange operations and non-regulated operations of the Company are not accounted for under SFAS No. 71 principles.

The local telephone exchange activities of the Company are subject to rate regulation by the FCC for interstate telecommunication service and the RCA for intrastate and local exchange telecommunication service. The Company, as required by the FCC, accounts for such activity separately. Long distance services of the Company are subject to rate regulation as a non-dominant interexchange carrier by the FCC for interstate telecommunication services and the RCA for intrastate telecommunication services. Wireless and Internet operations are not subject to rate regulation.

Comprehensive Income (Loss)

Comprehensive income (loss) represents net income (loss) plus the results of certain stockholders' equity changes from non-owner sources not reflected in the consolidated statements of operations.

Dividend Policy

During the fourth quarter of 2004, the Company adopted a dividend policy. In accordance with that dividend policy, the Company intends to pay quarterly dividends at an annual rate of \$0.74 per share for the first full year following the adoption of the policy, which it expects to review on at least an annual basis. The Company declared its first dividend on October 28, 2004, which was paid on January 19, 2005 to stockholders of record at the close of business on December 31, 2004. As of December 31, 2004, \$5,694 of dividends payable was accrued based on 30,695 shares outstanding and 79 shares of non-employee stock-based compensation deferred at the record date. Prior to announcing this dividend the Company had no history of paying dividends. Dividends on the Company's common stock are not cumulative.

Stock Incentive Plans

The Company applies Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, in accounting for its stock incentive plans. Accordingly, no compensation costs were recognized in operations in 2004, 2003 or 2002 related to options as all options were granted with exercise prices equal to or greater than fair value on the date of grant. If compensation costs had been determined consistent with SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*, the Company's net loss and net loss per share on a pro forma basis for 2004, 2003 and 2002 would have been as follows:

F-10

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)*Stock Incentive Plans (Continued)*

	2004	As Restated 2003	2002
Net loss:			
As reported	\$ (39,294)	\$ (6,630)	\$ (185,247)
Add: Stock-based employee compensation reported in net loss		900	\$
Deduct: Stock based compensation under fair value method	(1,938)	(888)	(1,713)
 Pro forma	 \$ (41,232)	 \$ (6,618)	 \$ (186,960)
 Net loss per share basic and diluted:			
As reported	\$ (1.33)	\$ (0.22)	\$ (5.89)
Pro forma	(1.39)	(0.22)	(5.94)

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for grants:

	2004	As Restated 2003	2002
Risk free rate	3.69%	3.39%	2.88%
Dividend yield	3.09%	0.00%	0.00%
Expected volatility factor	40.8%	55.5%	60.8%
Expected option life (years)	6.4	6.5	6.1

Subsequent to the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, the Company reassessed its stock compensation plan models in anticipation of adopting SFAS 123R *Share-Based Payment*, in 2005. During that assessment the Company identified certain corrections to the stock option valuation model assumptions. The footnote disclosure above has been restated to correct these factors. The primary causes of this restatement relate to the assumptions regarding the treatment of forfeitures and the period over which the compensation cost should be recorded. During the reassessment the Company also identified certain corrections to the stock option valuation model assumptions. As no stock-based compensation expense had yet been recorded by the Company, there is no change to the underlying financial statements other than this footnote. See Note 25 for a comparison to the previously reported numbers.

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. An Interpretation of Accounting Research Bulletin (ARB) No. 51. In December 2003, the FASB issued FIN 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R). FIN 46R provides guidance on how to identify variable interest entities and how to determine whether or not those entities should be consolidated. The Company was required to apply FIN 46R by the end of the first reporting period after March 15, 2004, for entities which were created before February 1, 2003. The adoption of FIN 46R was immediate for variable interest entities created after January 31, 2003. The Company evaluated the provisions of FIN 46R and determined that it does not have any variable interest entities that require consolidation in our financial statements.

In December 2004, the FASB issued SFAS No. 123(Revised), Share-Based Payment. This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires companies to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees and to record compensation cost for all stock awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. In addition, the Company is required to

F-11

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)*Stock Incentive Plans (Continued)*

record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. SFAS 123(R) will be effective in the Company's third quarter ending September 30, 2005. Management has not yet determined the impact that SFAS 123(R) will have on its financial position and results of operations, but expects that the stock incentive plans disclosure above provides a reasonable measure of the expected annual impact.

2. ACCOUNTS RECEIVABLE

Accounts receivable trade consists of the following at December 31, 2004 and 2003:

	2004	2003
Accounts receivable trade:		
Customers	\$ 30,892	\$ 31,916
Connecting companies	8,579	9,842
Other	4,811	4,825
	44,282	46,583
Less: allowance for doubtful accounts	4,869	4,865
Accounts receivable trade, net	\$ 39,413	\$ 41,718

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment consists of the following at December 31, 2004 and 2003:

	2004	2003
Property, plant and equipment:		
Land, buildings and support assets	\$ 193,073	\$ 191,314
Central office switching and transmission	300,624	296,253
Outside plant cable and wire facilities	479,491	466,019
Wireless switching and transmission systems	69,083	54,524
Other	2,403	3,490
Assets held for future use		3,599
Construction work in progress	17,093	26,705
	1,061,767	1,041,904
Less: Accumulated depreciation and amortization	649,455	603,760
Property, plant and equipment, net	\$ 412,312	\$ 438,144

The following is a summary of property held under capital leases included in the above property, plant and equipment:

	2004	2003
Property held under capital leases:		
Land, buildings and support assets	\$ 14,627	\$ 14,624

Outside plant cable and wire facilities	2,115	2,115
	16,742	16,739
Less: Accumulated depreciation and amortization	7,136	6,090
Property held under capital leases, net	\$ 9,606	\$ 10,649

F-12

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

3. PROPERTY, PLANT AND EQUIPMENT (Continued)

Amortization of assets under capital leases included in depreciation expense in 2004, 2003 and 2002 was \$1,046, \$1,740 and \$2,333, respectively.

The Company leases various land, buildings, right-of-ways and personal property under operating lease agreements. Rental expenses under operating leases for 2004, 2003 and 2002 were \$3,515, \$3,049 and \$3,733, respectively.

Future minimum payments under these operating leases for the next five years and thereafter are as follows:

2005	\$ 2,194
2006	1,394
2007	995
2008	784
2009	686
Thereafter	726
	\$ 6,779

4. GOODWILL AND OTHER INTANGIBLE ASSETS

Effective January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. In accordance with the guidelines of this accounting principle, goodwill and indefinite-lived intangible assets are no longer amortized but are assessed for impairment on at least an annual basis. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment.

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 the Company 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. The second step of the goodwill impairment test compares the implied fair value of goodwill of the reporting unit with the carrying amount of that goodwill. The implied fair value of a reporting unit's goodwill is the excess of the fair value of a reporting unit over the amounts assigned to assets and liabilities. If the carrying value amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

Also pursuant to SFAS No. 142, the Company annually reassesses previously recognized intangible assets and has ceased amortization of indefinite-lived intangible assets. Wireless and PCS licenses have terms of 10 years, but are renewable indefinitely through a routine process involving a nominal fee. The Company has determined that no legal, regulatory, contractual, competitive, economic or other factors currently exist that limit the useful life of its wireless and PCS licenses. Therefore, the Company is no longer amortizing its wireless and PCS licenses based on the determination that these assets have indefinite lives. In accordance with SFAS No. 142, the Company evaluates its determination of indefinite useful lives for its wireless and PCS licenses each reporting period. SFAS No. 142 requires that indefinite lived intangible assets be tested for impairment at least annually by comparing the fair value of the assets to their carrying amount. Upon adoption of SFAS No. 142 on January 1, 2002, the Company completed an impairment test for its wireless and PCS licenses that determined recognition of an impairment loss was not necessary, as the carrying value of its wireless and PCS licenses did not exceed their fair value. The Company performs its annual impairment test as of the beginning of the fourth quarter or more frequently if events or changes in

circumstance indicate possible impairment. The Company determined the fair value of its wireless and PCS licenses for purposes of these tests primarily by first performing a market value comparison of similar licenses against their carrying value and then performing a discounted cash flow valuation of the reporting unit against its total carrying value, including these licenses.

F-13

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

4. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

The Company has determined that its business segments constitute reporting units. The Company completed the initial step of impairment testing during the second quarter of 2002 which indicated that goodwill recorded in the local telephone, Internet, and interexchange segments was impaired as of January 1, 2002. Due to the potential impairment, the Company then completed the second step of the test to measure the amount of the impairment. The Company 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. Based on that analysis, a transitional impairment loss of \$105,350 was recognized as the cumulative effect of a change in accounting principle in the consolidated statement of operations as of January 1, 2002. The income tax benefit of \$39,540 was offset by a valuation allowance.

The Company performs its annual impairment test as of the beginning of the fourth quarter or more frequently if events or changes in circumstance indicate possible impairment. The Company determines 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. The annual impairment test conducted during the fourth quarters of 2004 and 2003 did not indicate any impairment of goodwill. For the year ended December 31, 2002, an impairment loss of \$64,755 in the local telephone segment was recognized in the consolidated statement of operations based on comparing the discounted cash flow model to the carrying value of the reporting units.

In connection with the Company's adoption of a plan to discontinue its wireless cable television service segment during the first quarter of 2002, the goodwill of that segment was considered impaired, and an impairment charge of \$3,165 is included with the results of discontinued operations. Also, \$38,822 of goodwill associated with the Company's directories business was sold during 2003.

In 2003, the Company accelerated the amortization of its other intangible assets. The following table provides the gross carrying value and accumulated amortization for each major class of intangible asset as of December 31, 2004 based on the Company's reassessment of previously recognized intangible assets and their remaining amortization lives in accordance with the adoption of SFAS No. 142:

	Gross Carrying Amount	Accumulated Amortization	Amortizable Life
Amortizable intangible assets:			
Customer lists	\$ 915	\$ (641)	5
Indefinite-lived intangible assets:			
Cellular licenses	\$ 18,194		
PCS licenses	3,323		
Domain names and trade names	80		
Total indefinite-lived intangible assets	\$ 21,597		

For amortizable intangible assets the total intangible amortization expense for the years ended December 31, 2004, 2003 and 2002 was \$183, \$951, and \$708, respectively. The estimated remaining amortization expense as of December 31, 2004 is \$183 and \$91 for the years ending December 31, 2005 and December 31, 2006, respectively.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

5. ACCOUNTS PAYABLE, ACCRUED AND OTHER CURRENT LIABILITIES

Accounts payable, accrued and other current liabilities consist of the following at December 31, 2004 and 2003:

	2004	2003
Accounts payable – trade	\$ 9,389	\$ 9,699
Accrued interest	8,717	9,226
Accrued payroll, benefits, and related liabilities	6,094	6,077
Dividend payable	5,694	
Accrued personal time off	4,746	5,031
Litigation reserves	4,188	3,880
Refundable access revenue	2,605	2,470
Loss on lease terminations	2,476	
Other	9,934	10,920
Accounts payable, accrued and other current liabilities	\$ 53,843	\$ 47,303

6. LONG-TERM OBLIGATIONS

The Company completed a common stock offering and refinancing transaction during the first quarter of 2005 which included the entering into of a new 2005 senior secured credit facility. The proceeds of the common stock offering and the 2005 senior credit facility, together with cash on hand, were used to repay in full and retire the 2003 senior secured credit facility, \$59,346 in principal of the outstanding 9 7/8% senior unsecured notes due 2011, and \$147,500 in principal of the senior subordinated notes due 2009 representing 100% of that issue, together with accrued interest and premiums. See Note 23, Subsequent Events.

On August 26, 2003, the Company completed the refinancing of its 1999 senior credit facility term loans. The Company entered into a \$250,000 new senior credit facility, the 2003 senior credit facility, consisting of a term loan facility in an aggregate principal amount of \$200,000 and an undrawn revolving credit facility of \$50,000. The Company simultaneously issued \$182,000 aggregate principal amount of 9 7/8% senior unsecured notes due 2011 at an issue price of approximately 96.7% for net proceeds of \$175,970. From these proceeds, the Company paid off the remaining \$320,727 of its 1999 senior credit facility, thereby extinguishing it. As a result of this early extinguishment of debt, the Company charged \$9,696 of unamortized debt issuance costs to interest expense in August 2003.

During the first quarter of 2003, the Company's lenders approved an amendment and waiver to its 1999 senior secured credit facility that, among other things, permitted the Company to sell its Directories Business and required that, in the event the sale was completed, 75% of proceeds would be used to repay outstanding 1999 senior secured credit facility term loans. This amendment and waiver became effective on May 8, 2003, and on May 13, 2003, the Company paid down \$106,650 of its outstanding term loans under its 1999 senior secured credit facility. As a result of this debt prepayment, the Company charged \$3,356 of pro-rata unamortized debt issuance costs attributable to the prepaid term loans to interest expense in May 2003.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

6. LONG-TERM OBLIGATIONS (Continued)

Long-term obligations consist of the following at December 31, 2004 and 2003:

	2004	2003
2003 senior credit facility	\$ 198,000	\$ 200,000
9 3/8% senior subordinated notes due 2009	147,500	150,000
9 7/8% senior unsecured notes due 2011	177,650	182,000
Original issue discount 9 7/8% senior subordinated notes due 2011	(5,321)	(5,856)
13% senior discount debentures due 2011		17,313
Original issue discount 13% senior discount debentures due 2011		(2,097)
Capital leases and other long-term obligations	8,060	8,860
	525,889	550,220
Less current portion	2,298	1,982
Long-term obligations, net of current portion	\$ 523,591	\$ 548,238

The aggregate maturities of long-term obligations for each of the five years and thereafter subsequent to December 31, 2004 are as follows:

2005	\$ 2,298
2006	2,309
2007	2,295
2008	2,126
2009	149,282
Thereafter	367,579
	\$ 525,889

As of December 31, 2004 and December 31, 2003, the Company was in compliance with all of its debt covenants.

2003 Senior Credit Facility

The 2003 senior secured credit facility provided a \$200,000 term loan and a revolving credit facility with a \$50,000 line of credit. The Company's obligations under the 2003 senior secured credit facility are unconditionally and irrevocably guaranteed, joint and severally, by the Company and its subsidiaries, and secured by collateral that includes substantially all of the Company and its subsidiaries' assets. The 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, and requires the Company to achieve certain financial ratios.

The term loan of \$200,000 is repayable in quarterly principal payments of \$500 which commence on March 31, 2004 with the balance due on maturity. The final maturity of the term is loan is August 26, 2010 or February 14, 2009 if the Company's senior subordinated notes have not been refinanced. The loan bears interest at an annual rate equal (at the Company's option) to: (1) LIBOR plus 3.25% or (2) a rate equal to 2.25% plus the greater of the administrative agent's prime rate or the federal funds rate plus 0.50%. The rate of interest in effect at December 31, 2004 was 5.25% and is based on the LIBOR rate option.

The senior secured credit facility also provides a revolving credit facility in the amount of \$50,000 that is available, in part, for up to \$25,000 in letters of credit and up to \$10,000 in the form of swingline loans. This revolving facility is

available through August 26, 2008 and outstanding balances thereunder currently will bear interest at an annual rate equal (at the Company's option) to: (1) LIBOR plus 3.00% or (2) a rate equal to 2.00% plus the greater of the administrative agent's prime rate or the federal funds rate plus 0.50%. There were no amounts outstanding under this revolving credit facility as of December 31, 2004.

F-16

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

6. LONG-TERM OBLIGATIONS (Continued)

On July 24, 1999, the Company entered into an interest rate swap agreement to reduce the impact of changes in interest rates on its floating rate long-term debt under the 1999 senior secured credit facility. This agreement fixed at 5.99% the underlying variable rate on one-half of the term loan borrowings under the old senior credit facility, or \$217,500, expiring in June 2004. The differential to be paid or received was recorded as interest expense in the consolidated statement of operations in the period in which it was recognized. The Company extinguished early its interest rate swap agreement in November 2003 for \$7,970, which it charged to interest expense.

Senior Subordinated Notes

On May 14, 1999, the Company issued \$150,000 in aggregate principal amount of 9 3/8 % senior subordinated notes due 2009. Interest on the notes is payable semi-annually on May 15 and November 15. The notes will mature on May 15, 2009, and are redeemable, in whole or in part, at the option of the Company, at any time on or after May 15, 2004 at 104.688% of the principal amount declining to 100% of the principal amount on or after May 15, 2007. The notes contain a number of restrictive covenants, including covenants limiting incurrence of debt and the payment of dividends.

Senior Unsecured Notes

On August 26, 2003, the Company issued \$182,000 in aggregate principal amount of 9 7/8 % senior unsecured notes due 2011. Interest on the notes is payable semi-annually on February 15 and August 15. The notes will mature on August 15, 2011, and are redeemable, in whole or in part, at the option of the Company, at any time on or after August 15, 2007 at 104.688% of the principal amount declining to 100% of the principal amount on or after August 15, 2010. The notes contain a number of restrictive covenants, including covenants limiting incurrence of debt and the payment of dividends.

Senior Discount Debentures

On May 14, 1999, the Company issued senior discount debentures due May 15, 2011. Interest accrues at 13.00% and is payable at the Company's option semiannually on May 15 and November 15, commencing May 15, 2000 until May 15, 2004 when the Company was required to semiannually pay interest. The outstanding debentures were redeemable, in whole or in part, at the option of the Company, at any time on or after May 15, 2004 at 106.5% of the principal amount declining to 100% of the principal amount on or after May 15, 2009. The debentures contained a number of restrictive covenants, including covenants limiting incurrence of debt and the payment of dividends.

The Company called its senior discount debentures on May 14, 2004, and subsequently redeemed and extinguished all of the senior discount debentures outstanding on June 14, 2004. As a result of this early extinguishment of debt, the Company charged \$330 of unamortized debt issuance costs and \$1,968 of unamortized original issue discount to interest expense in June 2004. The redemption was made at 106.5% of the outstanding principal and as a result a call premium of \$1,125 was paid and charged to interest expense in June 2004.

Capital leases and other long-term obligations

The Company has entered into various capital leases and other debt agreements totaling \$8,060 and \$8,860 with a weighted average interest rate of 9.75% and 9.71% at December 31, 2004 and 2003, respectively. Future minimum interest payments on capital leases at December 31, 2004 are \$4,100.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

7. OTHER DEFERRED CREDITS AND LONG-TERM LIABILITIES

Deferred credits and other long-term liabilities consists of the following at December 31, 2004 and 2003:

	2004	2003
Refundable access revenue	\$ 15,952	\$ 12,741
Additional pension liability	5,676	5,891
Other deferred credits	1,939	1,887
Regulatory liabilities accumulated removal costs	54,349	50,546
Deferred credits and other long-term liabilities	\$ 77,916	\$ 71,065

8. LOCAL TELEPHONE OPERATING REVENUE

Local telephone operating revenues consist of the following for the years ended December 31, 2004, 2003 and 2002:

	2004	2003	2002
Local network service	\$ 91,669	\$ 96,357	\$ 99,512
Network access revenue	97,536	97,759	108,335
Deregulated revenue and other	21,982	21,570	18,850
Local telephone operating revenues	\$ 211,187	\$ 215,686	\$ 226,697

9. CONTRACT TERMINATION AND ASSET IMPAIRMENT CHARGES

During the year ended December 31, 2003, the Company recorded \$54,858 in contract termination and asset impairment charges. These charges resulted from (1) the early termination of a 5 year comprehensive Telecommunications Partnering Agreement (TPA) with the State of Alaska and (2) an impairment of fiber optic indefeasible rights of use and IP network and service center assets resulting from the termination of the TPA and changes in the communications industry and the economy. The following table itemizes the components of the contract termination and asset impairment charges:

Contract termination charges:	
Contract termination cash settlement	\$ 3,448
Loss on disposal of assets	5,648
Accounts receivable and working capital write-downs	3,575
Total contract termination charges	\$ 12,671
Asset impairment charges	\$ 42,187
Total contract termination and asset impairment charges	\$ 54,858

Contract Termination Charges

On September 15, 2003, the Company received notification from the State of Alaska that it intended to terminate the TPA with the Company and disentangle. Subsequently, the Company and the State negotiated and agreed to a definitive Settlement Agreement and Mutual Release (the Settlement Agreement) effective October 14, 2003,

outlining the terms of disentanglement between the parties. Under the terms of the Settlement Agreement, the Company agreed to pay a cash settlement to the State of Alaska of \$3,448, one half of which was due upon signing the agreement and one half of which was due upon completion of disentanglement. The Company also agreed to transfer to the State title to certain assets used in providing services under the TPA which resulted in a net loss on disposal of those assets of \$5,648. Based on the terms of the Settlement Agreement, the Company determined that certain accounts receivable and working capital associated with the TPA will not be fully recoverable and wrote them down to their estimated net realizable value, resulting in a charge of \$3,575 during 2003.

F-18

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

9. CONTRACT TERMINATION AND ASSET IMPAIRMENT CHARGES (Continued)

Asset Impairment Charges

The Company reviews its property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. The Company was prompted to conduct an asset impairment review of its fiber optic Indefeasible Rights of Use (IRUs) that were acquired in 1999 and 2001 and certain IP network and certain service center assets due to the termination of the TPA by the State of Alaska as discussed above (which was a significant customer using these assets), indications that market pricing of similar assets were significantly below the Company's carrying value, and significant industry and economic trends affecting the Company's ability to generate positive cash flow from these assets in its interexchange and Internet segments. This review was conducted under the guidelines of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. As a result of its review, the Company determined that its carrying value of IRUs exceeded their fair value by \$27,128 and its carrying value of the IP network and service center assets exceeded their fair value by \$15,059. Accordingly, the Company recorded a \$42,187 impairment charge and wrote down the assets to their fair value during the third quarter of 2003.

10. GAIN ON DISPOSAL OF ASSETS

On April 28, 2003, the Company entered into an underwriting agreement with a syndicate of Canadian investment banks to complete the sale of a majority interest in the Directories Business. The Company subsequently filed on April 29, 2003, a final prospectus with Canadian securities regulators to sell a majority interest in its Directories Business in a public offering in Canada to the ACS Media Income Fund (the Fund), which is a Canadian income fund. The offering was sponsored by the Company. The transaction closed on May 8, 2003, with the Company selling an 87.42% interest and retaining a 12.58% interest in the Directories Business. The Company's retained 12.58% minority interest was recorded at an initial book value of \$1,077 representing the pro-rata retained ownership at historical book value, and accounted for under the equity method.

The Company also entered into an arrangement with the Metropolitan Life Insurance Company (MetLife) to provide a credit facility to its Directories Business on May 8, 2003 immediately prior to the sale of its Directories Business to the Fund. The Directories Business then drew \$35,000 of term loans against the facility, using \$1,468 to pay fees and expenses related to the debt issuance and \$87 to prepay an annual agency fee to MetLife. Of the \$33,445 in net cash proceeds, \$413 was deposited into the Directories Business as cash working capital and \$33,032 was distributed to the Company as a dividend. The credit facility is non-recourse to the Company.

The Fund then sold 17,500 units on May 8, 2003 for net proceeds of \$110,435, after deducting its underwriters' fees and transaction expenses of \$10,246. The Fund's net proceeds were used to acquire from the Company an 87.42% interest in the Directories Business. The Company received net proceeds of \$105,059 after deducting its fees and expenses associated with the Transaction of \$5,376. The Company recognized a gain on disposition of \$97,578 on a pre-tax basis.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

10. GAIN ON DISPOSAL OF ASSETS (Continued)

The following table indicates the Company's basis in assets sold to and liabilities assumed by the Fund and its retained interest in ACS Media LLC.

Net proceeds of the Transaction	\$ 105,059
Basis in Directories Business sold:	
Current assets	4,213
Property, plant and equipment, net	90
Goodwill	38,822
Debt issue costs	1,468
Current liabilities	(1,035)
Long-term debt	(35,000)
Basis of Directories Business	8,558
Equity in minority interest retained	(1,077)
Basis in net assets sold to the Fund	7,481
Gain on sale of Directories Business	\$ 97,578

On August 27, 2003, the Company was released from a lockup agreement relating to the remaining interest in the Directories Business and disposed of substantially all of its remaining interest through the exercise of its right to convert 99.23% of its then remaining 12.58% interest to 2,500 units of the ACS Media Income Fund, which were then sold in an underwritten offering. The transaction settled on September 4, 2003, generating \$17,177 in net proceeds after deducting transaction expenses of \$100, and resulted in a gain on disposition of \$15,940 after deducting the basis of \$1,237. As a result of this transaction, the Company now owns less than 0.1% of the Directories Business.

Related to the initial sale, the Company realized a gain on foreign exchange of \$4,104 as a result of currency fluctuation from April 28, 2003, the date the underwriting and investment agreements were executed, to May 8, 2003, the date the offering closed and the transaction was consummated. From the subsequent sale, the Company realized an additional gain on foreign exchange of \$157 as a result of currency fluctuation from August 27, 2003, the date the purchase agreement for substantially all of its remaining interest in the Directories Business was executed, to September 4, 2003, the date the transaction closed. The foreign exchange gains are included in Interest income and other in the Consolidated Statements of Operations.

In contemplation of the sale of the Directories Business, the Company formalized a number of agreements with ACS InfoSource, Inc. in May 2003 effective as of January 1, 2001, the day ACS InfoSource, Inc. was formed. ACS InfoSource, Inc. subsequently assigned certain contracts, including a 50-year directory publishing and distribution agreement and a 50-year license agreement, to ACS Media LLC as a part of the sale transaction. The Company also entered into a 45-year non-competition agreement and a 10-year billing and collection agreement directly with ACS Media LLC. The Company has a right to minority representation of one manager of the permitted nine managers of ACS Media LLC so long as its long-term contracts with ACS Media LLC are in effect. Leonard Steinberg, an officer of the Company, is a manager of ACS Media LLC.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

11. NON-OPERATING CHARGES

The Company periodically evaluates the fair value of its investments and other non-operating assets against their carrying value whenever market conditions indicate a change in that fair value. Any changes relating to declines in the fair value of non-operating assets are charged to non-operating expense under the caption Interest income and other in the Consolidated Statement of Operations. During the third quarter of 2003, the Company undertook an assessment of the net realizable value of its note receivable from Crest Communications LLC (Crest) and the option embedded in that note receivable to purchase certain network assets from Crest as a result of changes in market and economic conditions and a notice the Company received from the State of Alaska of termination of the TPA. As a result of the analysis, the Company recorded in Interest income and other in the Consolidated Statement of Operations a charge of \$15,924 representing the estimated decline in fair value of the note receivable from Crest. The Company still has purchase commitment obligations associated with this note receivable as described in Note 22.

12. INCOME TAXES

The difference between taxes calculated as if the statutory federal rate of 34% was applied to loss from continuing operations before income tax and the recorded tax benefit (expense) is reconciled as follows:

The income tax benefit (expense) is summarized as follows:

	2004	2003	2002
Computed federal income tax benefit at 34% statutory rate	\$ 13,434	\$ 1,864	\$ 24,570
(Increase) reduction in tax benefit resulting from:			
State income taxes (net federal benefit)	3,439	280	4,144
Original issue discount interest	(185)	(194)	(194)
Recovery of previously paid income tax	219		(313)
Write-off of original issue discount	(713)		
Excess compensation not allowed		(343)	
Other	(98)	(315)	(495)
Valuation allowance	(15,877)	(2,387)	(27,712)
Total income tax benefit (expense)	\$ 219	\$ (1,095)	\$

Current and deferred income taxes are summarized as follows:

	2004	2003	2002
Current:			
Federal income tax	\$ 185	\$ (928)	\$
State income tax	34	(167)	
Total current	219	(1,095)	
Deferred:			
Federal income tax			
State income tax			
Total deferred			
Total income tax benefit (expense)	\$ 219	\$ (1,095)	\$

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

12. INCOME TAXES (Continued)

The effect of significant items comprising the Company's net deferred tax liability at 34% were as follows:

	2004	2003	2002
Deferred tax liabilities – long-term:			
Property, plant and equipment	\$	\$	\$ (20,786)
Other	(105)	(103)	(88)
Total long-term deferred tax liabilities	(105)	(103)	(20,874)
Deferred tax assets:			
Current:			
Accrued compensation	2,537	4,030	4,249
Accrued bad debts	8,404	8,383	2,827
Interest rate swap mark to market			5,661
Minimum pension liability adjustment	1,812	1,817	1,893
Contingent liabilities	1,660		
Other	478	368	987
Total current deferred tax assets	14,891	14,598	15,617
Long-term:			
Net operating loss carryforwards from operations	54,503	35,358	58,728
Alternative minimum tax carryforward	876	1,095	
Intangibles	39,937	46,667	46,734
Debt issuance cost			1,335
Property, plant and equipment	1,669	1,244	
Other	437	81	
Total long-term deferred tax assets	97,422	84,445	106,797
Total deferred tax assets	112,313	99,043	122,414
Valuation allowance	(112,208)	(98,940)	(101,540)
Net deferred tax asset	\$	\$	\$

The Company has available at December 31, 2004 unused operating loss carryforwards of \$136,258 that may be applied against future taxable income and that expire as shown below. Per the schedule below the total Net Operating Loss (NOL) is made up of NOLs generated by the consolidated group and NOLs obtained with the 2000 acquisition of Internet Alaska. The Internet Alaska NOLs are limited by special rules known as Separate Return Limitation Year (SRLY) rules. SRLY NOLs can only be used in years that both the Consolidated Group and the entity that created the SRLY NOLs have taxable income. The tax benefits derived from the utilization of the SRLY NOLs will increase retained earnings.

Year of Expiration	Internet Alaska s SRLY	Unused Operating Loss Carryforwards	Total Unused Operating Loss Carryforwards
2017	\$ 27	\$	\$ 27
2018	328		328
2019	852		852
2020	2,631	26,175	28,806
2021		49,464	49,464
2022		18,850	18,850
2024		37,931	37,931
	\$ 3,838	\$ 132,420	\$ 136,258

F-22

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

13. DISCONTINUED OPERATIONS

On March 30, 2002, the Company approved a plan to sell its wireless cable television service segment. As a result of this decision, the operating revenue and expense of this segment have been classified as discontinued operations under SFAS No. 144 for all periods presented, and the assets and liabilities of the disposal group have been written down to their fair value, net of expected selling expenses. The income tax benefit in all periods was offset by a valuation allowance. The Company completed the disposal of its wireless cable television segment as of March 31, 2003. The following discloses the results of the discontinued operations for years ended December 31, 2004, 2003 and 2002:

	2004	2003	2002
Operating revenue	\$	\$ 110	\$ 716
Operating expense		162	1,255
Operating loss		(52)	(539)
Interest expense			(33)
Loss from operations of discontinued segment		(52)	(572)
Write down of net assets to fair value			(7,060)
Loss from discontinued operations	\$	\$ (52)	\$ (7,632)

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

14. EARNINGS PER SHARE

Earnings per share is based on weighted average number of shares of common stock and dilutive potential common shares 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 reflects 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. Due to the Company's reported net losses, potential common shares, which consisted of 3,184, 3,839 and 3,374 options granted to employees and 79, 56 and 56 deferred shares granted to directors, were anti-dilutive for the years ended December 31, 2004, 2003 and 2002 respectively. The following table sets forth the computation of basic and diluted earnings per share for the years ending December 31, 2004, 2003 and 2002.

	2004	2003	2002
Numerator:			
Loss from continuing operations	\$ (39,294)	\$ (6,578)	\$ (72,265)
Loss from discontinued operations		(52)	(7,632)
Loss before cumulative effect of change in accounting principle	(39,294)	(6,630)	(79,897)
Cumulative effect of change in accounting principle			(105,350)
Net loss	\$ (39,294)	\$ (6,630)	\$ (185,247)
Denominator:			
Weighted average shares outstanding basic & diluted	29,592	29,980	31,474
Basic and diluted earnings per share:			
Loss from continuing operations	\$ (1.33)	\$ (0.22)	\$ (2.30)
Loss from discontinued operations			(0.24)
Loss before cumulative effect of change in accounting principle	(1.33)	(0.22)	(2.54)
Cumulative effect of change in accounting principle			(3.35)
Net loss	\$ (1.33)	\$ (0.22)	\$ (5.89)

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

15. 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 December 31, 2004, ACS Group has reserved a total of 10,060 shares of authorized common stock for issuance under the plans. In general, options under the plans vest ratably over three, four or five years and the plans terminate in approximately 10 years.

Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan

ACS Group has reserved 7,160 shares under this plan, which was adopted by the Company in November 1999. At December 31, 2004, 7,089 options have been granted, 2,892 have been forfeited, 2,013 have been exercised, and 2,963 shares are available for grant under the plan.

Information on outstanding options under the plan for the years ended December 31, 2004, 2003 and 2002 is summarized as follows:

	2004		2003		2002	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding, January 1	2,839	\$ 7.20	3,374	\$ 7.52	3,606	\$
Granted	1,177	4.69	200	4.88	278	7.82
Exercised	(1,569)	6.07			(76)	6.08
Canceled or expired	(263)	11.52	(735)	8.04	(434)	7.59
Outstanding, December 31	2,184	6.09	2,839	7.20	3,374	7.52
Options exercisable at December 31	1,028	\$ 8.29	2,226	\$ 7.16	2,329	\$ 7.15
Weighted average fair value of options granted		6.09		2.84		4.57

The outstanding options at December 31, 2004 have the following characteristics:

	Outstanding Options			Exercisable Options	
	Number of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
Range of Exercise Prices					
\$4.35 - \$7.00	1,888	8.09	\$ 5.03	538	\$ 5.77
\$8.00	60	7.15	8.00	53	8.00
\$12.63 - \$14.20	236	5.14	14.09	236	14.09

F-25

Table of Contents

**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)**

15. STOCK INCENTIVE PLANS (Continued)

ACS Group, Inc. 1999 Non-Employee Director Stock Compensation Plan

The non-employee director stock compensation plan was adopted by ACS Group in November 1999. ACS Group has reserved 350 shares under this plan. At December 31, 2004, 143 shares have been awarded and 207 shares are available for grant under the plan. For the years ended December 31, 2004 and 2002, directors were required to receive not less than 25% of their annual retainer and meeting fees in the form of ACS Group's stock and may have elected to receive up to 100% of director's compensation in the form of stock. During the year ended December 31, 2004, 33 shares under the plan were awarded to directors, of which 23 were elected to be deferred until termination of service by the directors. In 2003, directors were not provided the option of receiving stock and received their entire annual retainer and meeting fees in cash, therefore no shares were awarded from this plan during 2003. During the year ended December 31, 2002, 58 shares under the plan were awarded to directors, of which 34 were elected to be deferred until termination of service by the directors.

Alaska Communications Systems Group, Inc. 1999 Employee Stock Purchase Plan

This plan was also adopted by ACS Group in November 1999. ACS Group has reserved 1,550 shares under this plan. At December 31, 2004, 980 shares are available for issuance and sale. The plan will terminate on December 31, 2009. All ACS Group employees and all of the employees of designated subsidiaries generally will be eligible to participate in the purchase plan, other than employees whose customary employment is 20 hours or less per week or is for not more than five months in a calendar year, or who are ineligible to participate due to restrictions under the Internal Revenue Code.

On December 31, 2004, 32 shares were issued under the plan. On June 30, 2004, 41 shares were issued under the plan. On December 31, 2003, 43 shares were issued under the plan. On June 30, 2003, 87 shares were issued under the plan. On December 31, 2002, 98 shares were issued under the plan. On June 28, 2002, 53 shares were issued under the plan.

A participant in the purchase plan may authorize regular salary deductions of a maximum of 15% and a minimum of 1% of base compensation. The fair market value of shares which may be purchased by any employee during any calendar year may not exceed \$25. The amounts so deducted and contributed are applied to the purchase of full shares of common stock at 85% of the lesser of the fair market value of such shares on the date of purchase or on the offering date for such offering period. The offering dates are January 1 and July 1 of each purchase plan year, and each offering period will consist of one six-month purchase period. The first offering period under the plan commenced on January 1, 2000. Shares are purchased on the open market or issued from authorized but unissued shares on behalf of participating employees on the last business days of June and December for each purchase plan year and each such participant has the rights of a stockholder with respect to such shares. During the year ended December 31, 2004, approximately 13% of eligible employees elected to participate in the plan.

2003 Options for Officer Inducement Grant

During 2003, the Company's Board of Directors awarded 1,000 options as an inducement grant in hiring the Company's Chief Executive Officer, all of which are currently outstanding. The options were registered with the Securities Exchange Commission on Form S-8 during October 2004.

16. 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 contribution plan, the accumulated benefits and plan assets are not determined for or allocated separately to the individual employer. The Company's contribution to the plan for 2004, 2003 and 2002 was \$12,342, \$12,654, and \$13,390, respectively.

The Company also provides a 401(k) retirement savings plan covering substantially all of its employees. The plan allows for discretionary matching contributions as determined by the Board of Directors, subject to Internal Revenue

Code limitations. There was no matching contribution for 2004, 2003, or 2002.

F-26

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

16. RETIREMENT PLANS (Continued)

The Company also 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'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 plan is not adequately funded under ERISA at December 31, 2004 and management is evaluating whether to make a contribution in 2005 for the 2004 plan year. Since the plan was adequately funded under ERISA at December 31, 2003, no contribution was made in 2004 for the 2003 plan year. During 2003, the Company made a voluntary contribution of \$600 to the plan for the 2002 plan year. The Company uses a December 31 measurement date for the plan.

The following is a reconciliation of the beginning and ending balances for 2004 and 2003 for the projected benefit obligation and the plan assets of the ACS Retirement Plan:

	2004	2003
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 12,446	\$ 10,615
Amortization of prior service cost	(203)	(203)
Interest cost	748	731
Actuarial loss	853	1,631
Benefits paid	(517)	(328)
 Projected benefit obligation at end of year	 \$ 13,327	 \$ 12,446
 Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 9,671	\$ 7,684
Return on plan assets	915	1,715
Contribution by employer		600
Benefits paid	(517)	(328)
 Fair value of plan assets at end of year	 \$ 10,069	 \$ 9,671

The following table represents the funded status of the ACS Retirement Plan at December 31, 2004 and 2003:

	2004	2003
Projected benefit obligation	\$ (13,327)	\$ (12,446)
Plan assets at fair value	10,069	9,671
 Funded Status	 (3,258)	 (2,775)

Unrecognized prior service cost	1,145	1,348
Unrecognized net loss	4,531	4,543
Net amount recognized	\$ 2,418	\$ 3,116

F-27

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

16. RETIREMENT PLANS (Continued)

The net amounts recognized in the balance sheet were classified as follows at December 31, 2004 and 2003:

	2004	2003
Accrued benefit liability	\$ (3,258)	\$ (2,775)
Intangible asset	1,145	1,348
Accumulated other comprehensive loss	4,531	4,543
Net amount recognized	\$ 2,418	\$ 3,116

The accumulated benefit obligation for the plan was \$13,327 and \$12,446 at December 31, 2004 and 2003, respectively. The decrease in minimum liability included in comprehensive loss was \$12 and \$191 for the years ended December 31, 2004 and 2003, respectively.

The following table represents the net periodic pension expense for the ACS Retirement Plan for 2004, 2003 and 2002:

	2004	2003	2002
Interest cost	\$ 748	\$ 731	\$ 680
Expected return on plan assets	(754)	(664)	(723)
Amortization of loss	502	568	260
Amortization of prior service cost	203	203	203
Net periodic pension expense	\$ 699	\$ 838	\$ 420

The assumptions used to account for the plan as of December 31, 2004 and 2003 are as follows:

	2004	2003
Discount rate for projected benefit obligation	5.75%	6.00%
Discount rate for pension expense	6.00%	6.75%
Expected long-term rate of return on assets	8.00%	8.00%
Rate of compensation increase	0.00%	0.00%

The expected long-term rate of return on assets rate is the best estimate of future expected return for the asset pool, given the expected returns and allocation targets for the various classes of assets.

The plan's asset allocations at December 31, 2004 and 2003, by asset category are as follows:

Asset Category	2004	2003
Equity securities*	72%	73%
Debt securities*	28%	26%
Other/Cash	0%	1%
Total	100%	100%

* Note that
mutual funds

that may contain
both stocks and
bonds may be
included in
these categories.

F-28

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

16. RETIREMENT PLANS (Continued)

The fundamental investment objective of the plan is to generate a consistent total investment return sufficient to pay plan benefits to retired employees, while minimizing the long term cost to the Company. The long term (10 year and beyond) plan asset growth objective is to achieve a rate of return that exceeds the actuarial interest assumption after fees and expenses. Because of the Company's long-term investment objectives, the Plan administrator is directed to resist being reactive to short term capital market developments and to maintain an asset mix that is continuously rebalanced to adhere to the plan investment mix guidelines. The Plan's investment goal is to protect the assets' longer term purchasing power. The Plan's assets are managed in a manner that emphasizes a higher exposure to equity markets versus other asset classes. It is expected that such a strategy will provide a higher probability of meeting the plan's actuarial rate of return assumption over time.

Based on risk and return history for capital markets along with asset allocation risk and return projections, the following asset allocation guidelines were developed for the plan:

	Minimum	Maximum
Large US equity	30%	70%
Small US equity	5%	15%
Non-US equity	5%	15%
Fixed income	20%	60%
Cash equivalents	0%	10%

The benefits expected to be paid in the each of the next five years, and in the aggregate for the five fiscal years thereafter, are as follows:

2005	\$ 570
2006	608
2007	666
2008	735
2009	791
2010-2014	4,502

The Company also has a separate executive post retirement health benefit plan. The Alaska Communications Systems Executive Retiree Health Benefit Plan (The ACS Health Plan) was adopted by the Company in November 2001 and amended in October 2002. The ACS Health Plan covers a select group of former management employees. The ACS Health Plan provides a graded subsidy for medical, dental, and vision coverage. The Compensation Committee of the Board of Directors decided to terminate the ACS Health Plan in January 2004. In February 2005, the Board adopted a resolution to exclude a former employee from the plan, causing a \$90 decrease in the accumulated post retirement benefit. Three people qualified under the plan are eligible for future benefits, but the plan is closed to future participants.

The Company uses the projected unit credit method for the determination of post retirement health cost for financial reporting and funding purposes and complies with the funding requirements under ERISA. The Company made a contribution of \$51 to the ACS Health Plan during 2004. No contribution was made for 2003 or 2002 and the Company does not plan to make a contribution during 2005. The Company uses a December 31 measurement date for the plan.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

16. RETIREMENT PLANS (Continued)

The following is a reconciliation of the beginning and ending balances for 2004 and 2003 for the projected benefit obligation and the plan assets for the ACS Health Plan:

	2004	2003
Change in accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation at beginning of the year	\$ 265	\$ 268
Plan amendment	(90)	
Service cost	6	14
Interest cost	16	18
Actuarial (gain)/loss	2	(35)
Accumulated postretirement benefit obligation at end of the year	\$ 199	\$ 265
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 138	\$ 127
Return on plan assets	10	11
Contributions	51	
Fair value of plan assets at end of year	\$ 199	\$ 138

The following represents the net periodic postretirement benefit expense for the ACS Health Plan for 2004, 2003 and 2002:

	2004	2003	2002
Service cost	\$ 6	\$ 14	\$ 69
Interest cost	16	18	40
Expected return on plan assets	(11)	(10)	(11)
Amortization of prior service cost	7	7	24
Curtailed loss	14		
Net periodic postretirement benefit expense	\$ 32	\$ 29	\$ 122

The following table represents the funded status of the ACS Health Plan at December 31, 2004 and 2003:

	2004	2003
Accumulated postretirement benefit obligation	\$ (199)	\$ (265)
Plan assets at fair value	199	138
Funded status		(127)
Unrecognized prior service cost		111
Unrecognized net gain	(25)	(28)

Accrued benefit costs \$ (25) \$ (44)

The actuarial assumptions used to account for the ACS Health Plan as of December 31, 2004 and 2003 is an assumed discount rate of 5.75% and 6.00% for projected benefit obligation and an assumed discount rate of 6.75% and 6.00% for plan expense, respectively, and an expected long term rate of return on plan assets of 8.00% and 8.00%, respectively. The expected long-term rate of return on assets is the best estimate of future expected return for the asset pool, given the expected returns and allocation targets for the various classes of assets.

F-30

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

16. RETIREMENT PLANS (Continued)

For measurement purposes, the assumed annual rates of increase in health care costs are as follows:

Year	Pre 65 premiums	Post 65 premiums
1	10.00%	7.00%
2	9.00%	7.00%
3	8.00%	7.00%
4	7.00%	7.00%
5 and thereafter	7.00%	7.00%

Assumed health care cost trend rates have a significant effect on the amounts reported for the ACS Health Plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2004:

	+1%	-1%
Effect on total of service and interest cost components		
Effect on accumulated postretirement benefit obligation	(3)	(4)

The ACS Health Plan's asset allocations at December 31, 2004 and 2003, by asset category, are as follows:

Asset Category	2004	2003
Equity securities*	31%	33%
Debt securities*	58%	56%
Other/Cash	11%	11%
Total	100%	100%

*Note that mutual funds that may contain both stock and bonds may be included in these categories.

The fundamental investment objective of the plan is to realize an annual total investment return consistent with the conservative risk tolerance plan dictated by the Company. The investment profile of the plan emphasizes liquidity and income, some capital stock investment and some fluctuation of investment return. It is anticipated that the investment manager will achieve this objective by investing the account's assets in mutual funds. The portfolio may hold common stock, fixed income securities, money market instruments and U.S. Treasury obligations.

Based on risk and return history for capital markets along with asset allocation risk and return projections, the following asset allocation guidelines were developed for the plan:

Asset Category	Target
Equity securities	30%
Fixed income	60%
Other/cash	10%

Edgar Filing: ALASKA COMMUNICATIONS SYSTEMS GROUP INC - Form 10-K/A

The benefits expected to be paid in each of the next five years, and in the aggregate for the five fiscal years thereafter are as follows:

2005	\$	6
2006		10
2007		10
2008		10
2009		17
2010 - 2014		86

F-31

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

17. BUSINESS SEGMENTS

The Company has four reportable segments: local telephone, wireless, Internet and interexchange. Local telephone provides landline telecommunications services and consists of local telephone service, network access and deregulated and other revenue; wireless provides wireless telecommunications service; Internet provides Internet service and advanced IP based private networks; and interexchange provides switched and dedicated long distance services. Each reportable segment is a strategic business and offering different services than those offered by the other segments. The Company evaluates the performance of its segments based on operating income (loss).

Previously, the Company reported its Directories Business as a separate segment. The Company sold an 87.42% interest in its Directories Business during the second quarter of 2003 and is no longer directly engaged in day-to-day management of that business. As a result of this transaction, the Directories Business no longer constitutes a reportable segment. Accordingly, the historical operating results for the Directories Business are included in All Other in the accompanying tables. The Company also had a wireless cable television service segment that did not meet the criteria for a reportable segment and was previously included in All Other and is now reported as discontinued operations.

The Company also incurs interest expense, interest income, equity in earnings of investments and other operating and non operating income and expense at the corporate level which are not allocated to the business segments, or 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 either the Company or 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 year ended December 31, 2004:

	Local Telephone	Wireless	Internet	Interexchange	All Other	Eliminations	Total
Operating revenues	\$211,169	\$ 56,743	\$ 20,280	\$ 17,067	\$ 23,097	\$ (25,649)	\$302,707
Depreciation and amortization	52,368	7,480	3,925	430	14,184		78,387
Operating income (loss)	13,298	4,257	(10,304)	(3,402)	6,269		10,118
Interest expense	(311)	(13)		(187)	(50,777)		(51,288)
Interest income					1,857		1,857
Income tax benefit (provision)	(5,254)	(1,854)			7,327		219
Income (loss) from continuing operations	7,733	2,390	(10,304)	(3,589)	(35,524)		(39,294)
Total assets	482,062	113,024	2,923	22,695	16,423		637,127
Capital expenditures	26,426	13,935	4,654	5	6,402		51,422

Operating revenues disclosed above include intersegment operating revenues of \$25,612 for local telephone, \$2,048 for wireless, \$2,667 for interexchange and \$23,251 for all other. In accordance with SFAS No. 71, intercompany revenues between local telephone and non-local telephone operations are not eliminated above.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

17. BUSINESS SEGMENTS (Continued)

The following table illustrates selected financial data for each segment as of and for the year ended December 31, 2003:

	Local					Eliminations	Total
	Telephone	Wireless	Internet	Interexchange	All Other		
Operating revenues	\$215,675	\$ 46,628	\$ 33,026	\$ 20,562	\$ 37,205	\$ (29,249)	\$323,847
Depreciation and amortization	51,235	6,527	8,759	1,068	14,596		82,185
Operating income (loss)	24,365	3,043	(60,442)	(21,012)	129,450	(9)	75,395
Interest expense	(441)	(5)	(67)	(164)	(70,793)		(71,470)
Interest income	30				1,719		1,749
Income tax benefit (provision)	(9,950)	(1,412)			10,267		(1,095)
Income (loss) from continuing operations	14,004	1,626	(60,513)	(21,176)	59,490	(9)	(6,578)
Total assets	508,154	102,431	23,315	27,959	23,532		685,391
Capital expenditures	24,113	13,018	5,255	98	8,422		50,906

Operating revenues disclosed above include intersegment operating revenues of \$27,620 for local telephone, \$1,801 for wireless, \$2,482 for interexchange and \$493 for all other. In accordance with SFAS No. 71, intercompany revenues between local telephone and non-local telephone operations are not eliminated above.

The following table illustrates selected financial data for each segment as of and for the year ended December 31, 2002:

	Local					Eliminations	Total
	Telephone	Wireless	Internet	Interexchange	All Other		
Operating revenues	\$226,697	\$43,233	\$ 20,848	\$ 26,350	\$ 58,411	\$ (35,145)	\$340,394
Depreciation and amortization	55,498	5,541	6,744	2,256	12,901		82,940
Operating income (loss)	34,700	2,207	(23,265)	(708)	(35,622)	(76)	(22,764)
Interest expense	435	(5)	(146)	(330)	(51,658)		(51,704)
Interest income	3	3		2	2,416		2,424
Income tax benefit (provision)	(13,214)	(1,527)			14,741		
Income (loss) from continuing operations	19,199	2,113	(21,619)	(1,583)	(70,299)	(76)	(72,265)
Total assets	575,211	83,601	(27,156)	7,412	113,441		752,509
Capital expenditures	31,186	14,007	16,604	228	10,596		72,621

Operating revenues disclosed above include intersegment operating revenues of \$22,634 for local telephone, \$1,786 for wireless, \$13,965 for interexchange and \$1,400 for all other. In accordance with SFAS No. 71,

intercompany revenues between local telephone and non-local telephone operations are not eliminated above.

18. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Fox Paine & Company, ACS Group's majority stockholder, received an annual management fee in the amount of 1% of the Company's net income before interest expense, interest income, income taxes, depreciation and amortization, and equity in earnings (loss) of investments, calculated without regard to the fee pursuant to an agreement dated May 14, 1999. The management fee expense for 2004, 2003 and 2002 was \$943, \$930, and \$1,316, respectively. The management fee payable at December 31, 2004 and 2003 was \$946 and \$950, respectively. The annual management fee obligation to Fox Paine was terminated effective for periods beginning after December 31, 2004 as partial consideration for a \$2.7 million transaction fee paid to Fox Paine in February 2005 in connection with assistance rendered in structuring a stock offering and refinancing transaction that the Company completed during the first quarter of 2005. The transaction fee agreement was approved by the Company's board of directors. See Note 23, Subsequent Events.

F-33

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

18. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS (Continued)

The board of directors approved the payment to Fox Paine & Company of a fee equal to 1% of the gross proceeds generated from the sale of the Company's Directories Business upon closing such sale, plus expenses in connection with such transaction, including the reimbursement by the Company of the \$250 consulting fee and transaction bonus paid to an officer under the agreement described below. The Company paid Fox Paine & Company a fee of \$2,095 on May 8, 2003.

Fox Paine & Company entered into a consulting agreement with an officer of the Company for services rendered for the benefit of the Company related to the sale of the Company's Directories Business. Under this agreement, the officer was paid a lump sum consulting fee and transaction bonus of \$250 in May 2003. As described above, Fox Paine & Company was reimbursed for this expense.

In August 2003, the board of directors also approved the payment of a fee equal to 1% of the gross proceeds generated from the refinancing of the Company's debt. The Company paid Fox Paine & Company \$3,760 on August 28, 2003.

On September 19, 2003, Fox Paine entered into a consulting agreement with a now retired officer of the Company. The consulting term began on January 1, 2004, continued for one year, and was terminated on December 31, 2004. During the consulting term, the retired officer advised Fox Paine on and evaluated potential opportunities in the telecommunications industry, and Fox Paine paid the former officer a monthly fee of \$20 for those services.

Two of the Company's directors, Messrs. Saul A. Fox and W. Dexter Paine, III are co-founders of Fox Paine and currently serve as Fox Paine's Chief Executive Officer and President. A third director of the Company, Mr. Wray T. Thorn, is a former Director of Fox Paine.

On April 17, 2001, the Company issued an interest bearing note receivable to an officer totaling \$328. The note bore interest at the Mid-Term Applicable Federal Rate and was due on April 15, 2005. The note was secured by a pledge of 100 shares of ACS Group's stock held in the officer's name. In accordance with an addendum to the officer's employment agreement dated May 3, 2001, the loan was to be forgiven ratably over a three year period ending April 16, 2004. Accordingly, \$114 was forgiven on April 16, 2002 and recognized as compensation expense. Upon the closing of the sale of the Company's Directories Business on May 8, 2003 for which the officer received a fee of \$840, he waived certain rights under his employment agreement, including the forgiveness terms of this indebtedness that would have occurred during 2003 and 2004. On May 8, 2003, the officer paid off the note balance of \$238, including accrued interest.

During 2003, the Company spun off its Directory Business to ACS Media LLC and subsequently sold 99.9% of its interest in ACS Media LLC to the public through a Canadian income fund. As part of that transaction, the Company entered into several long-term contracts with ACS Media LLC, including a 50-year publishing agreement, a 50-year license agreement, a 45-year non-compete agreement, and a 10-year billing and collection agreement. At December 31, 2004, and 2003, respectively, the Company had recorded in accounts payable affiliates \$3,027 and \$2,867 due to ACS Media LLC under these contracts, primarily under the billing and collection agreement. The Company has a right to minority representation of one manager of the permitted nine managers of ACS Media LLC so long as its contracts with ACS Media LLC are in effect. Currently, Leonard A. Steinberg, an officer of the Company, is a manager of ACS Media LLC.

On September 14, 2003, the Company entered into an agreement with a retiring officer to reacquire 267 shares of the Company's stock owned by the officer in January 2004 at a purchase price per share equal to the highest average closing price of a share of the Company's stock during any 5-consecutive day trading period in January 2004. The officer delivered the shares to the Company in 2004, and the Company made repurchase payments totaling \$1,262 to the officer in four equal quarterly installments commencing on March 31, 2004. Under SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, the obligation was initially measured at fair value. If the obligation had been settled on December 31, 2003, the Company would have paid

\$1,265 for those shares and, accordingly, \$1,265 was included in Accounts payable affiliates on the Consolidated Balance Sheets of the Company at that date. As of December 31, 2003, the Company classified the 267 shares as shares subject to mandatory redemption within stockholders equity on the Consolidated Balance Sheets.

F-34

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

18. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS (Continued)

On May 14, 1999, the Company entered into a stockholders' agreement with Fox Paine Capital Fund, investors affiliated with Fox Paine Capital Fund and several non-fund investors, including co-investors and some of the Company's former officers. Under the stockholders' agreement, subject to limited exceptions, Fox Paine Capital Fund and its affiliates, as a group, may make up to six demands for registration under the Securities Act of their shares of common stock, and the Company is obligated to bear the fees and expenses of such registration and offering other than underwriting discounts.

19. ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Commencing January 1, 2001, the Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its corresponding amendments under SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The accounting for changes in fair value of a derivative depends on the intended use of the derivative and its designation as a hedge. Derivatives that are not hedges must be adjusted to fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in fair value of derivatives either offset the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or are recognized in other comprehensive income until the hedged transaction is recognized in earnings. The change in a derivative's fair value related to the ineffective portion of a hedge, if any, is immediately recognized in earnings.

The Company has used derivative financial instruments to partially hedge variable interest transactions in the past and expects to do so in the future when appropriate for managing interest rate risk. In accordance with this policy, the Company entered into a variable-to-fixed interest rate swap agreement during 1999. The Company extinguished early that 1999 interest rate swap agreement in November 2003. Subsequently during February 2005, in connection with a refinancing transaction, the Company entered into floating-to-fixed interest rate swaps in order to hedge its exposure to variable interest rates associated with the 2005 senior credit facility and to comply with the terms of that agreement with respect to variable interest rate risk exposure. See Note 23, Subsequent Events.

To the extent that derivatives financial instruments are outstanding as of a period end, the fair value of those instruments, represented by the estimated amount the Company would receive or pay to terminate the agreement, is reported on the its balance sheet. The realized gains and losses of the 1999 interest rate swap are recorded net in interest expense on the Company's Consolidated Statements of Operations. For the years ended December 31, 2003 and 2002, realized changes in the fair value of the cash flow hedge amounted to a charge of \$15,647 and \$9,046, of which the ineffective portion was \$231 and \$59, respectively. Both the realized effective and ineffective components of the cash flow hedge were recorded as an increase to interest expense.

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values of cash and cash equivalents, accounts receivable and payable, and other short-term monetary assets and liabilities approximate carrying values due to their short-term nature. The fair value for the Company's 2003 and 1999 senior secured credit facility, senior subordinated notes and senior unsecured notes, and capital leases and other long-term obligations were estimated based on quoted market prices.

The following table summarizes the Company's carrying values and fair values of the debt components of its financial instruments at December 31, 2004:

	Carrying Value	Fair Value
2003 senior secured credit facility	\$ 198,000	\$ 200,723
9 3/8% senior subordinated notes due 2009	147,500	152,294
9 7/8% senior unsecured notes due 2011	172,329	190,974

Capital leases and other long-term obligations	8,060	8,060
	\$ 525,889	\$ 552,051

F-35

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

20. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table summarizes the Company's carrying values and fair values of the debt components of its financial instruments at December 31, 2003:

	Carrying Value	Fair Value
2003 senior secured credit facility	\$ 200,000	\$ 201,500
9 3/8% senior subordinated notes due 2009	150,000	150,000
9 7/8% senior unsecured notes due 2011	176,144	191,100
13% senior discount debentures due 2011	15,216	20,870
Capital leases and other long-term obligations	8,860	8,860
	\$ 550,220	\$ 572,330

Subsequent to December 31, 2004, the 2003 senior secured credit facility was redeemed and retired at its carrying value, the senior subordinated notes were tendered in part and called in part at a premium of 104.688% and the entire issue was retired, and \$59,346 aggregate principal amount of the senior unsecured notes were tendered and retired at a premium of 109.875%. See Note 23, Subsequent Events.

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

ACS Holdings and its subsidiaries are guarantors of ACS Group's senior discount debentures. Additionally, ACS Group and ACS Holdings' subsidiaries are guarantors under ACS Holdings' 9 3/8 % senior subordinated notes and 9 7/8/% senior unsecured notes. All ACS Group's and Holdings' subsidiaries (the Combined Subsidiaries) are 100% owned. The guarantees are full and unconditional. In addition, all guarantees are joint and several. Accordingly, the interim condensed consolidating financial statements are presented below.

F-36

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Balance Sheet
December 31, 2004

	Combined	ACS	ACS		ACS Group
	Subsidiaries	Holdings	Group	Eliminations	Group
Assets	Parent Only	Parent Only	Parent Only	Consolidated	Consolidated
Current assets:					
Cash and cash equivalents	\$ 99	\$ 50,561	\$	\$	\$ 50,660
Restricted cash		4,690			4,690
Short term investments		35,200			35,200
Accounts receivable-trade, net	15,397	24,857		(841)	39,413
Accounts receivable-affiliates	12,490	(13,578)	1,088		
Materials and supplies	6,623				6,623
Prepayments and other current assets	1,493	2,231			3,724
Total current assets	36,102	103,961	1,088	(841)	140,310
Investments	10	360,418	(30,804)	(329,614)	10
Property, plant and equipment	957,589	104,178			1,061,767
Less: accumulated depreciation and amortization	590,471	58,984			649,455
Property, plant and equipment, net	367,118	45,194			412,312
Goodwill				38,403	38,403
Intangible assets, net	21,871				21,871
Debt issuance costs, net		15,482			15,482
Deferred charges and other assets	1,772	6,967			8,739
Total assets	\$ 426,873	\$ 532,022	\$ (29,716)	\$ (292,052)	\$ 637,127
Liabilities and Stockholders Equity					
Current liabilities:					
Current portion of long-term obligations	\$ 548	\$ 1,750	\$	\$	\$ 2,298
Accounts payable-affiliates	2,964	1,009			3,973
Accounts payable, accrued and other current liabilities	14,705	40,784	(805)	(841)	53,843
	8,942	6			8,948

Advance billings and customer deposits

Total current liabilities	27,159	43,549	(805)	(841)	69,062
Long-term obligations, net of current portion	4,114	519,477			523,591
Deferred income taxes	1,345	(1,345)			
Other deferred credits and long-term liabilities	72,240	5,676			77,916
Commitments and contingencies					
Stockholders' equity:					
Common stock	2		352	(2)	352
Treasury stock			(18,443)		(18,443)
Paid in capital in excess of par value	491,240	287,242	282,272	(778,482)	282,272
Retained earnings (accumulated deficit)	(169,227)	(318,046)	(293,092)	487,273	(293,092)
Accumulated other comprehensive loss		(4,531)	(4,531)	4,531	(4,531)
Total stockholders' equity	322,015	(35,335)	(33,442)	(286,680)	(33,442)
Total liabilities and stockholders' equity	\$ 426,873	\$ 532,022	\$ (34,247)	\$ (287,521)	\$ 637,127

F-37

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Balance Sheet
December 31, 2003

	Combined	ACS	ACS		ACS Group
	Subsidiaries	Holdings	Group	Eliminations	Group
Assets	Parent Only	Parent Only	Parent Only		Consolidated
Current assets:					
Cash and cash equivalents	\$ 139	\$ 54,437	\$	\$	\$ 54,576
Restricted cash		3,635			3,635
Short term investments		43,222			43,222
Accounts receivable-trade, net	13,803	27,915			41,718
Accounts receivable-affiliates	33,777	(33,629)	(148)		
Materials and supplies	10,027	72			10,099
Prepayments and other current assets	2,877	2,973			5,850
Total current assets	60,623	98,625	(148)		159,100
Investments		399,384	18,449	(417,833)	
Property, plant and equipment	931,840	110,064			1,041,904
Less: accumulated depreciation and amortization	553,816	49,944			603,760
Property, plant and equipment, net	378,024	60,120			438,144
Goodwill				38,403	38,403
Intangible assets, net	22,055				22,055
Debt issuance costs, net		18,587	352		18,939
Deferred charges and other assets	2,501	6,249			8,750
Total assets	\$ 463,203	\$ 582,965	\$ 18,653	\$ (379,430)	\$ 685,391
Liabilities and Stockholders Equity					
Current liabilities:					
Current portion of long-term obligations	\$ 500	\$ 1,767	\$ (285)	\$	\$ 1,982
Accounts payable-affiliates	2,867	950	1,265		5,082
Accounts payable, accrued and other current liabilities	15,038	31,953	312		47,303

Edgar Filing: ALASKA COMMUNICATIONS SYSTEMS GROUP INC - Form 10-K/A

Income taxes payable		1,095			1,095
Advance billings and customer deposits	8,766				8,766
Total current liabilities	27,171	35,765	1,292		64,228
Long-term obligations, net of current portion	4,661	528,076	15,501		548,238
Deferred income taxes	5,220	(5,220)			
Other deferred credits and long-term liabilities	65,170	5,895			71,065
Commitments and contingencies					
Stockholders' equity:					
Common stock	25		336	(25)	336
Shares subject to mandatory redemption			(1,198)		(1,198)
Treasury stock			(17,118)		(17,118)
Paid in capital in excess of par value	501,374	287,242	278,181	(788,616)	278,181
Retained earnings (accumulated deficit)	(140,418)	(264,250)	(253,798)	404,668	(253,798)
Accumulated other comprehensive loss		(4,543)	(4,543)	4,543	(4,543)
Total stockholders' equity	360,981	18,449	1,860	(379,430)	1,860
Total liabilities and stockholders' equity	\$ 463,203	\$ 582,965	\$ 18,653	\$ (379,430)	\$ 685,391

F-38

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Statement of Operations
Year Ended December 31, 2004

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Operating revenue:					
Local telephone	\$ 211,169	\$ 23,097	\$	\$ (23,079)	\$ 211,187
Wireless	56,743			(49)	56,694
Internet	20,280			(107)	20,173
Interexchange	17,067			(2,414)	14,653
Total operating revenue	305,259	23,097		(25,649)	302,707
Operating expense:					
Local telephone (exclusive of depreciation and amortization)	145,507	2,585		(20,174)	127,918
Wireless (exclusive of depreciation and amortization)	42,179			(4,261)	37,918
Internet (exclusive of depreciation and amortization)	26,689			(950)	25,739
Interexchange (exclusive of depreciation and amortization)	20,037			(264)	19,773
Depreciation and amortization	64,203	14,184			78,387
Loss (gain) on disposal of assets, net	2,795	59			2,854
Total operating expense	301,410	16,828		(25,649)	292,589
Operating income	3,849	6,269			10,118
Other income (expense):					
Interest expense	(511)	(46,234)	(4,543)		(51,288)
Interest income and other		1,641			1,641
Total other expense	(511)	(44,593)	(4,543)		(49,647)
Income (loss) before income taxes	3,338	(38,324)	(4,543)		(39,529)
Income tax benefit (expense)	(5,620)	5,839			219
	16	(2,266)	(34,751)	37,017	16

Equity in income (loss) of
investments

Net loss	\$	(2,266)	\$	(34,751)	\$	(39,294)	\$	37,017	\$	(39,294)
----------	----	---------	----	----------	----	----------	----	--------	----	----------

F-39

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Statement of Operations
Year Ended December 31, 2003

	Combined	ACS	ACS		ACS Group
	Subsidiaries	Holdings Parent Only	Group Parent Only	Eliminations	Consolidated
Operating revenue:					
Local telephone	\$ 215,675	\$ 25,574	\$	\$ (25,563)	\$ 215,686
Wireless	46,628			(80)	46,548
Directory	11,631				11,631
Internet	33,026				33,026
Interexchange	20,562			(3,606)	16,956
Total operating revenue	327,522	25,574		(29,249)	323,847
Operating expense:					
Local telephone (exclusive of depreciation and amortization)	136,860	1,298		(21,505)	116,653
Wireless (exclusive of depreciation and amortization)	34,922			(3,858)	31,064
Directory (exclusive of depreciation and amortization)	5,359			(110)	5,249
Internet (exclusive of depreciation and amortization)	47,066			(1,543)	45,523
Interexchange (exclusive of depreciation and amortization)	27,766			(2,224)	25,542
Other (exclusive of depreciation and amortization)	9			(9)	
Contract termination and asset impairment charges	54,858				54,858
Depreciation and amortization	67,591	14,594			82,185
Loss (gain) on disposal of assets, net	(112,642)	20			(112,622)
Total operating expense	261,789	15,912		(29,249)	248,452
Operating income	65,733	9,662			75,395
Other income (expense):					
Interest expense	(677)	(68,145)	(2,648)		(71,470)
Interest income and other	4,287	(14,478)			(10,191)
Total other income (expense)	3,610	(82,623)	(2,648)		(81,661)

Income (loss) before income taxes and discontinued operations	69,343	(72,961)	(2,648)		(6,266)
Income tax benefit (expense)	(62,680)	61,585			(1,095)
Equity in income (loss) of investments	783	7,394	(3,982)	(3,412)	783
Income (loss) from continuing operations	7,446	(3,982)	(6,630)	(3,412)	(6,578)
Loss from discontinued operations	(52)				(52)
Net income (loss)	\$ 7,394	\$ (3,982)	\$ (6,630)	\$ (3,412)	\$ (6,630)

F-40

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Statement of Operations
Year Ended December 31, 2002

	Combined	ACS	ACS		ACS
	Subsidiaries	Holdings	Group		Group
		Parent Only	Parent	Eliminations	Consolidated
			Only		
Operating revenue:					
Local telephone	\$ 226,697	\$	\$	\$	\$ 226,697
Wireless	43,233			(53)	43,180
Directory	33,604				33,604
Internet	20,848			(1)	20,847
Interexchange	26,350			(10,284)	16,066
Other	716	24,807		(25,523)	
Total operating revenue	351,448	24,807		(35,861)	340,394
Operating expense:					
Local telephone (exclusive of depreciation and amortization)	136,503	2,188		(23,859)	114,832
Wireless (exclusive of depreciation and amortization)	35,380			(6,028)	29,352
Directory (exclusive of depreciation and amortization)	14,189			(19)	14,170
Internet (exclusive of depreciation and amortization)	37,344			(6,045)	31,299
Interexchange (exclusive of depreciation and amortization)	24,766			(1,119)	23,647
Other (exclusive of depreciation and amortization)	1,158			(1,158)	
Depreciation and amortization	70,181	12,890		(131)	82,940
Loss on disposal of assets	204			1,959	2,163
Goodwill impairment loss		64,755			64,755
Total operating expense	319,725	79,833		(36,400)	363,158
Operating income (loss)	31,723	(55,026)		539	(22,764)
Other income (expense):					
Interest expense	(79)	(49,067)	(2,591)	33	(51,704)
Interest income and other	(37)	(3,978)	(182,656)	188,874	2,203
Total other expense	(116)	(53,045)	(185,247)	188,907	(49,501)

Income (loss) before income taxes, discontinued operations and cumulative effect of change in accounting principle	31,607	(108,071)	(185,247)	189,446	(72,265)
Income tax benefit (expense)	(22,718)	22,718			
Income (loss) from continuing operations	8,889	(85,353)	(185,247)	189,446	(72,265)
Loss from discontinued operations	(6,810)	(250)		(572)	(7,632)
Income (loss) before cumulative effect of change in accounting principle	2,079	(85,603)	(185,247)	188,874	(79,897)
Cumulative effect of change in accounting principle	(8,297)	(97,053)			(105,350)
Net loss	\$ (6,218)	\$ (182,656)	\$ (185,247)	\$ 188,874	\$ (185,247)

F-41

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Statement of Cash Flows
Year Ended December 31, 2004

	Combined	ACS	ACS		ACS
	Subsidiaries	Holdings	Group	Eliminations	Group
		Parent Only	Parent Only		Consolidated
Net cash provided (used) by operating activities	\$ 89,264	\$ 16,669	\$ 8,837	\$ (55,745)	\$ 59,025
Cash Flows from Investing Activities:					
Construction and capital expenditures	(52,105)	683			(51,422)
Purchase of short term investments		(154,650)			(154,650)
Proceeds from sale of short term investments		162,672			162,672
Placement of funds in escrow		(1,055)			(1,055)
Net cash provided (used) by investing activities	(52,105)	7,650			(44,455)
Cash Flows from Financing Activities:					
Payments on long-term debt	(499)	(9,150)	(17,313)		(26,962)
Dividends	(36,700)	(19,045)		55,745	
Issuance of common stock			9,801		9,801
Purchase of treasury stock			(1,325)		(1,325)
Net cash provided (used) by financing activities	(37,199)	(28,195)	(8,837)	55,745	(18,486)
Increase in cash and cash equivalents	(40)	(3,876)			(3,916)
Cash and cash equivalents, beginning of the period	139	54,437			54,576
Cash and cash equivalents, end of the period	\$ 99	\$ 50,561	\$	\$	\$ 50,660

Supplemental Cash Flow Data:

Interest paid, net of capitalized interest	\$	520	\$	42,506	\$	2,444	\$	45,470
Income taxes paid				876				876
Supplemental Noncash Transactions:								
Minimum pension liability adjustment	\$		\$	(12)	\$		\$	(12)
Dividend declared					(5,679)			(5,679)

F-42

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Statement of Cash Flows
Year Ended December 31, 2003

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Net cash provided (used) by operating activities	\$ 47,296	\$ 167,055	\$ 5,563	\$ (169,503)	\$ 50,411
Cash Flows from Investing Activities:					
Construction and capital expenditures	(40,199)	(8,367)			(48,566)
Purchase of short term investments		(100,053)			(100,053)
Proceeds from sale of short term investments		57,831			57,831
Net proceeds from sale of business	155,269				155,269
Release of funds from escrow		3,539			3,539
Placement of funds in escrow		(3,725)			(3,725)
Net cash provided (used) by investing activities	115,070	(50,775)			64,295
Cash Flows from Financing Activities:					
Payments on long-term debt	(3,181)	(430,921)			(434,102)
Proceeds from issuance of long-term debt		375,970			375,970
Debt issuance costs		(14,000)			(14,000)
Dividends	(158,973)	(10,530)		169,503	
Issuance of common stock			267		267
Purchase of treasury stock			(5,830)		(5,830)
Net cash provided (used) by financing activities	(162,154)	(79,481)	(5,563)	169,503	(77,695)
Increase in cash and cash equivalents	212	36,799			37,011
Cash and cash equivalents, beginning of the period	(73)	17,638			17,565

Cash and cash equivalents, end of the period	\$	139	\$	54,437	\$		\$	54,576
Supplemental Cash Flow Data:								
Interest paid, net of capitalized interest	\$	685	\$	48,436	\$	2,251	\$	51,372
Income taxes paid								
Supplemental Noncash Transactions:								
Property acquired under a mortgage	\$	2,340	\$		\$		\$	2,340
Minimum pension liability adjustment				(191)				(191)
Interest rate swap marked to market				(14,152)				(14,152)
				F-43				

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

21. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)
Condensed Consolidated Statement of Cash Flows
Year Ended December 31, 2002

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Net cash provided (used) by operating activities	\$ 59,261	\$ 7,695	\$ (972)	\$	\$ 65,984
Cash Flows from Investing Activities:					
Construction and capital expenditures	(57,838)	(10,596)			(68,434)
Purchase of short term investments		(32,400)			(32,400)
Proceeds from sale of short term investments		42,100			42,100
Release of funds from escrow		3,706			3,706
Issuance of note receivable		(15,000)			(15,000)
Net cash provided by investing activities	(57,838)	(12,190)			(70,028)
Cash Flows from Financing Activities:					
Payments on long-term debt	(2,735)	(4,593)			(7,328)
Dividends		(2,347)	2,347		
Issuance of common stock			972		972
Purchase of treasury stock			(2,347)		(2,347)
Net cash provided (used) by financing activities	(2,735)	(6,940)	972		(8,703)
Decrease in cash and cash equivalents	(1,312)	(11,435)			(12,747)
Cash and cash equivalents, beginning of the period	1,239	29,073			30,312
Cash and cash equivalents, end of the period	\$ (73)	\$ 17,638	\$	\$	\$ 17,565

Supplemental Cash Flow Data:

Interest paid, net of capitalized interest	\$	86	\$	44,617	\$	2,227	\$	46,930
--	----	----	----	--------	----	-------	----	--------

Income taxes paid

Supplemental Noncash

Transactions:

Property acquired under capital leases and mortgages	\$	4,187	\$		\$		\$	4,187
--	----	-------	----	--	----	--	----	-------

Minimum pension liability adjustment				2,342				2,342
--------------------------------------	--	--	--	-------	--	--	--	-------

Interest rate swap marked to market				2,715				2,715
-------------------------------------	--	--	--	-------	--	--	--	-------

F-44

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

22. 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 \$4,188 as of December 31, 2004 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.

A class action lawsuit was filed against the Company in May 2001. The litigation alleges various contract and tort claims concerning the Company's decision to terminate its Infinite Minutes long distance plan. In September 2004, the Company entered into a settlement agreement with plaintiffs' counsel. As a class action, the court granted preliminary approval of the settlement and provided an opportunity for members of the class to review the proposed settlement and file objections. On February 18, 2005, the court granted final approval of the settlement agreement and dismissed the case.

On July 15, 2002 the Company fulfilled a commitment to Crest to provide a loan for the aggregate principal amount of \$15,000 in return for certain consideration. The Company has an agreement that enables it to purchase additional fiber optic capacity in future years from Crest, the expenditures for which are expected to be significant and may exceed \$20,000 over the next two years. While the Company has an agreement with Crest, certain material terms of the agreement remain subject to continued renegotiation. The significant provisions of this agreement are: i) purchase commitments by the Company for capacity in 2005 and 2007, the final price and quantity of which are subject to future events, ii) Crest's restoration of the Company's traffic carried on another cable system, iii) and specific interconnection arrangements between the Company and Crest, should the Company exercise its option to purchase certain network assets from Crest. The Company is currently negotiating open elements of its agreement with Crest and renegotiating other terms and conditions of the agreement. It is impossible to determine the ultimate outcome of these negotiations at this time.

23. SUBSEQUENT EVENTS

On December 20, 2004, the Company filed a shelf Registration Statement on Form S-3 with the Securities Exchange Commission registering 15,000 primary shares of its common stock and 19,599 secondary shares of its common stock on behalf of selling stockholders. Subsequently, on January 26, 2005, the Company offered to the public 8,824 shares of its common stock for \$75,000, or \$8.50 per share which offering closed and settled on February 1, 2005. The offering generated net proceeds of approximately \$67,500 after underwriting discounts and expenses of the offering. Under the terms of the underwriting agreement for this offering, the underwriters were granted an over-allotment option to sell up to an additional 1,324 shares at \$8.50. They exercised in part their over-allotment option for a total of 1,074 shares, which settled on March 2, 2005, and generated an additional \$8,669 of net proceeds after underwriting discounts. No secondary shares of common stock that were registered on behalf of the selling stockholders on the Form S-3 Registration Statement were offered or sold to the public in this offering.

Simultaneous with the offering of common stock, the Company negotiated and entered into a new \$380,000 bank credit facility (the 2005 senior secured credit facility) which consists of a drawn term loan of \$335,000 and an undrawn revolver of \$45,000. The 2005 senior secured credit facility also closed on February 1, 2005, and generated net proceeds of approximately \$324,300 after deducting fees and expenses associated with the debt issuance of approximately \$10,700. The \$335,000 term loan generally bears interest at Libor plus 2.0% per annum, has a term of seven years and has no scheduled principal payments prior to maturity. The revolver, to the extent it is drawn, also generally bears interest at Libor plus 2.0% per annum and, to the extent undrawn, has commitment fees equal to 0.375% per annum. The term of the revolver is six years and is collateralized by substantially all assets of the Company. The approximately \$10,700 of fees and expenses have been charged to debt issuance costs and will be amortized over the term of the 2005 bank credit facility.

In connection with the 2005 senior secured credit facility, the Company entered into floating-to-fixed interest rate swaps as a component of its interest rate hedging strategy and to fulfill a requirement of the 2005 senior secured credit

agreement. The total notional amount of the swaps is \$135,000, the variable interest rate component paid to the Company is three-month Libor and the fixed interest rate component paid by the Company is 4.13%. The term of the 2005 swap agreement is five years.

F-45

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

The net proceeds of the common stock offering and the 2005 senior secured credit facility were used, together with cash on hand, to repay in full and retire the 2003 senior secured credit facility on February 1, 2005, and to tender and extinguish on February 10, 2005, \$59,346 in outstanding principal of the Company's 9 7/8% senior unsecured notes due 2011 and \$140,070 in outstanding principal of the Company's 9 3/8% senior subordinated notes due 2009. All remaining principal, or \$7,430, of the 9 3/8% senior subordinated notes due 2009 have been called and are were extinguished in full on March 3, 2005. The Company has or will have incurred tender and call premiums and expenses of approximately \$13,000 and incur a charge of approximately \$13,000 as a result of writing off unamortized debt issuance costs and original issue discount in association with these early extinguishments of debt during the first quarter of 2005.

In connection with assistance rendered in structuring the Company's common stock offering and 2005 senior bank credit facility, the Company paid a \$2.7 million transaction fee to Fox Paine in February 2005. The transaction fee agreement was approved by the Company's board of directors, and has been included in the expenses of the common stock offering and debt issuance costs for the 2005 senior secured credit facility discussed above.

24. CONSOLIDATED QUARTERLY OPERATING INFORMATION (UNAUDITED)

	Quarterly Financial Data				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2004					
Operating revenues	\$ 75,455	\$ 75,354	\$ 76,773	\$ 75,125	\$ 302,707
Operating income	3,098	7,788	(4,815)	4,047	10,118
Loss from continuing operations	(8,769)	(7,219)	(16,241)	(7,065)	(39,294)
Net loss	(8,769)	(7,219)	(16,241)	(7,065)	(39,294)
Loss per share - basic and diluted:					
Net loss	(0.30)	(0.24)	(0.55)	(0.23)	(1.33)
2003					
Operating revenues	\$ 83,792	\$ 84,296	\$ 78,522	\$ 77,237	\$ 323,847
Operating income	6,600	103,500	(37,884)	3,179	75,395
Loss from continuing operations	(6,537)	92,724	(75,570)	(17,195)	(6,578)
Loss on discontinued operations	(52)				(52)
Net loss	(6,589)	92,724	(75,570)	(17,195)	(6,630)
Loss per share - basic and diluted:					
Loss from continuing operations	(0.21)	3.08	(2.54)	(0.55)	(0.22)
Net loss	(0.21)	3.08	(2.54)	(0.55)	(0.22)

During the year ended December 31, 2003, the Company recorded \$54,858 in contract termination and asset impairment charges (see Note 9), recognized a gain on disposition of assets of \$113,518 on a pre-tax basis (see Note 10) and recorded an impairment charge of \$15,924 on non-operating assets (see Note 11).

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

25. RESTATEMENT OF FINANCIAL STATEMENTS*Short term investments*

The Company invests in auction-rate securities and other short-term investments as part of its cash management strategy. These investments had been historically classified as cash and cash equivalents because of the short duration of their interest reset periods. Subsequent to the issuance of its financial statements for the year ended December 31, 2004, the Company determined, based upon supplemental accounting interpretation regarding the financial statement classification of auction-rate securities and in consultation with the audit committee, that these investments and other short-term investments should not be classified as cash equivalents due to their underlying long-term stated maturities. As a result, the accompanying financial statements have been restated to change the classification of auction-rate securities and other short-term investments to a separate line item within current assets and to reflect purchases and sales of auction-rate securities and other short-term investments as investing cash flows in the statements of cash flows.

Following is a summary of the effects of the change in classification described above:
Consolidated Balance Sheet Information:

	As of December 31, 2004			As of December 31, 2003		
	As		As	As		As
	Previously	Adjustment		Previously	Adjustment	
	Reported	Adjustment	Restated	Reported	Adjustment	Restated
Cash and cash equivalents	\$ 85,860	\$ (35,200)	\$ 50,660	\$ 97,798	\$ (43,222)	\$ 54,576
Short term Investments	\$	\$ 35,200	\$ 35,200	\$	\$ 43,222	\$ 43,222

Consolidated Statement of Cash Flows Information:

	Year ended		Year ended	
	December 31, 2004		December 31, 2003	
	As		As	
	Previously	As Restated	Previously	As Restated
	Reported	As Restated	Reported	As Restated
Purchases of short-term investments	\$	\$ (154,650)	\$	\$ (100,053)
Proceeds from sale of short-term investments	\$	\$ 162,672	\$	\$ 57,831
Cash flows from investing activities	\$ (52,477)	\$ (44,455)	\$ 106,517	\$ 64,295
Net increase (decrease) in cash and cash equivalents	\$ (11,938)	\$ (3,916)	\$ 79,233	\$ 37,011
Cash and cash equivalents, beginning of the year	\$ 97,798	\$ 54,576	\$ 18,565	\$ 17,565
Cash and cash equivalents, end of the year	\$ 85,860	\$ 50,660	\$ 97,798	\$ 54,576

	Year ended	
	December 31, 2002	
	As	
	Previously	As Restated
	Reported	As Restated
Purchases of short-term investments	\$	\$ (32,400)
Proceeds from sale of short-term investments	\$	\$ 42,100

Edgar Filing: ALASKA COMMUNICATIONS SYSTEMS GROUP INC - Form 10-K/A

Cash flows from investing activities	\$ (79,728)	\$ (70,028)
Net increase (decrease) in cash and cash equivalents	\$ (22,447)	\$ (12,747)
Cash and cash equivalents, beginning of the year	\$ 41,012	\$ 30,312
Cash and cash equivalents, end of the year	\$ 18,565	\$ 17,565

F-47

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2004, 2003 and 2002
(In Thousands, Except Per Share Amounts)

25. RESTATEMENT OF FINANCIAL STATEMENTS (Continued)*Cash Paid to Affiliate*

The Company also restated its financial statements to reflect the cash payments of \$1,262 made during the year ended December 31, 2004 related to the reacquisition of 267 shares of the Company's stock owned by a retired officer (see Note 18).

	Year ended December 31, 2004	
	As	
	Previously Reported	As Restated
Accounts payable and other current liabilities	\$ (1,176)	\$ 22
Cash flows from operating activities	\$ 57,827	\$ 59,025
Purchases of treasury stock	\$ (127)	\$ (1,325)
Cash flows from financing activities	\$ (17,288)	\$ (18,486)

Stock Incentive Plans

Subsequent to the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, the Company reassessed its stock compensation plan models in anticipation of adopting SFAS 123R, *Share-Based Payment*, in 2005. The primary causes of this restatement relate to the treatment of forfeitures and the period over which the compensation cost should be recorded. During the reassessment the Company also identified certain corrections to the stock option valuation model assumptions. The footnote disclosure in Note 1 has been restated to correct these factors. As no stock-based compensation expense had yet been recorded by the Company, there is no change to the underlying financial statements other than Note 1.

	As Reported			As Restated		
	2004	2003	2002	2004	2003	2002
Net loss:						
As reported	\$ (39,294)	\$ (6,630)	\$ (185,247)	\$ (39,294)	\$ (6,630)	\$ (185,247)
Pro forma	(40,381)	(6,787)	(186,702)	(41,232)	(6,618)	(186,960)
Net loss per share - basic and diluted:						
As reported	\$ (1.33)	\$ (0.22)	\$ (5.89)	\$ (1.33)	\$ (0.22)	\$ (5.89)
Pro forma	(1.36)	(0.23)	(5.93)	(1.39)	(0.22)	(5.94)

	As Reported			As Restated		
	2004	2003	2002	2004	2003	2002
Risk free rate	4.13%	3.39%	2.88%	3.69%	3.39%	2.88%
Dividend yield	0.0%	0.0%	0.0%	3.09%	0.00%	0.00%
Expected volatility factor	40.8%	55.5%	60.8%	40.8%	55.5%	60.8%
Expected option life (years)	6.1	6.8	6.1	6.4	6.5	6.1

F-48

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Schedule II Valuation and Qualifying Accounts
(In Thousands)

Description	Balance at Beginning of Period	Charged to costs and expenses	Charged to other accounts (1)	Deductions (2)	Balance at End of Period
2004 Allowance for doubtful accounts	\$ 4,865	\$ 2,922	\$ 948	\$ (3,866)	\$ 4,869
2003 Allowance for doubtful accounts	\$ 6,075	\$ 839	\$ 2,582	\$ (4,631)	\$ 4,865
2002 Allowance for doubtful accounts	\$ 4,944	\$ 4,884	\$ 214	\$ (3,967)	\$ 6,075

(1) Represents the reserve for accounts receivable collected on the behalf of others.

(2) Represents credit losses.

F-49