

ALASKA COMMUNICATIONS SYSTEMS GROUP INC

Form 10-Q

November 06, 2008

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from _____ to _____.

Commission file number 000-28167

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

52-2126573
(I.R.S. Employer
Identification No.)

600 Telephone Avenue, Anchorage, Alaska 99503
(Address of Principal Executive Offices) (Zip Code)
(907) 297-3000

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former name, former address and former three months, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large
accelerated
filer

Accelerated
filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes No

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

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

under a plan confirmed by a court.

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of the registrant's Common Stock, as of October 20, 2008, was 43,630,115.

TABLE OF CONTENTS

| | Page Number |
|---|------------------------|
| PART I. Financial Information | |
| Item 1. Financial Statements: | |
| <u>Consolidated Balance Sheets Unaudited As of September 30, 2008 and December 31, 2007</u> | 3 |
| <u>Consolidated Statements of Operations (unaudited) For the Three and Nine months Ended September 30, 2008 and 2007</u> | 4 |
| <u>Consolidated Statements of Stockholders' Equity (Deficit) (unaudited) For the Nine months Ended September 30, 2008</u> | 5 |
| <u>Consolidated Statements of Cash Flows (unaudited) For the Nine months Ended September 30, 2008 and 2007</u> | 7 |
| <u>Notes to Consolidated Financial Statements (unaudited)</u> | 8 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 20 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 29 |
| <u>Item 4. Controls and Procedures</u> | 29 |
| PART II. Other Information | |
| <u>Item 1. Legal Proceedings</u> | 29 |
| <u>Item 1A. Risk Factors</u> | 29 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 29 |
| <u>Item 3. Defaults upon Senior Securities</u> | 30 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 30 |
| <u>Item 5. Other Information</u> | 30 |
| <u>Item 6. Exhibits</u> | 30 |
| Signatures | 31 |
| <u>EX-31.1</u> | |
| <u>EX-31.2</u> | |
| <u>EX-32.1</u> | |
| <u>EX-32.2</u> | |

Table of Contents

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

| | September 30, 2008 | December 31, 2007 |
|--|-----------------------------------|----------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 26,203 | \$ 35,208 |
| Restricted cash | 57,424 | 2,589 |
| Short-term investments | | 790 |
| Accounts receivable-trade, net of allowance of \$5,645 and \$8,768 | 37,452 | 39,150 |
| Materials and supplies | 10,722 | 10,467 |
| Prepayments and other current assets | 6,122 | 5,155 |
| Deferred income taxes | 11,385 | 21,347 |
| Total current assets | 149,308 | 114,706 |
| Property, plant and equipment | 1,311,793 | 1,209,257 |
| Less: accumulated depreciation and amortization | (873,512) | (825,663) |
| Property, plant and equipment, net | 438,281 | 383,594 |
| Non-current investments | 1,095 | |
| Goodwill | 38,403 | 38,403 |
| Intangible assets | 21,604 | 21,604 |
| Debt issuance costs | 9,935 | 7,461 |
| Deferred taxes | 100,489 | 96,095 |
| Deferred charges and other assets | 3,962 | 1,340 |
| Total assets | \$ 763,077 | \$ 663,203 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Current portion of long-term obligations | \$ 649 | \$ 780 |
| Accounts payable, accrued and other current liabilities | 67,197 | 64,070 |
| Advance billings and customer deposits | 10,146 | 10,051 |
| Total current liabilities | 77,992 | 74,901 |
| Long-term obligations, net of current portion | 556,030 | 432,216 |
| Other deferred credits and long-term liabilities | 82,354 | 82,075 |
| Total liabilities | 716,376 | 589,192 |
| Commitments and contingencies | | |
| Stockholders equity (deficit): | | |

Edgar Filing: ALASKA COMMUNICATIONS SYSTEMS GROUP INC - Form 10-Q

| | | |
|---|------------|------------|
| Common stock, \$.01 par value; 145,000 authorized, 43,627 and 42,883 issued and outstanding, respectively | 436 | 429 |
| Additional paid in capital | 222,353 | 257,982 |
| Accumulated deficit | (168,585) | (177,313) |
| Accumulated other comprehensive loss | (7,503) | (7,087) |
| Total stockholders' equity | 46,701 | 74,011 |
| Total liabilities and stockholders' equity | \$ 763,077 | \$ 663,203 |

See Notes to Consolidated Financial Statements

3

Table of Contents

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

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Operating revenues: | | | | |
| Wireline | \$ 62,100 | \$ 63,395 | \$ 184,277 | \$ 184,237 |
| Wireless | 39,222 | 37,159 | 108,177 | 102,441 |
| Total operating revenues | 101,322 | 100,554 | 292,454 | 286,678 |
| Operating expenses: | | | | |
| Wireline (exclusive of depreciation and amortization) | 47,629 | 45,300 | 134,871 | 133,986 |
| Wireless (exclusive of depreciation and amortization) | 22,778 | 19,763 | 63,701 | 53,578 |
| Depreciation and amortization | 18,790 | 17,492 | 54,391 | 53,583 |
| Loss on disposal of assets, net | 4 | 113 | 763 | 137 |
| Total operating expenses | 89,201 | 82,668 | 253,726 | 241,284 |
| Operating income | 12,121 | 17,886 | 38,728 | 45,394 |
| Other income and expense: | | | | |
| Interest expense | (8,548) | (7,474) | (24,453) | (22,439) |
| Loss on extinguishment of debt | | (355) | | (355) |
| Interest income | 532 | 485 | 1,541 | 1,520 |
| Other | (331) | (72) | (482) | (64) |
| Total other income and expense | (8,347) | (7,416) | (23,394) | (21,338) |
| Income before income tax expense | 3,774 | 10,470 | 15,334 | 24,056 |
| Income tax expense | (1,730) | (170) | (6,606) | (275) |
| Net income | \$ 2,044 | \$ 10,300 | \$ 8,728 | \$ 23,781 |
| Net income per share: | | | | |
| Basic | \$ 0.05 | \$ 0.24 | \$ 0.20 | \$ 0.56 |
| Diluted | \$ 0.05 | \$ 0.23 | \$ 0.20 | \$ 0.54 |
| Weighted average shares outstanding: | | | | |
| Basic | 43,603 | 42,812 | 43,302 | 42,649 |

| | | | | |
|---------|--------|--------|--------|--------|
| Diluted | 44,428 | 44,159 | 44,306 | 44,185 |
|---------|--------|--------|--------|--------|

See Notes to Consolidated Financial Statements

4

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Stockholders Equity
Nine months Ended September 30, 2008
(Unaudited, In Thousands Except Per Share Amounts)

| | Shares | Common Stock | Additional Paid in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Stockholders Equity |
|--|--------|-----------------|----------------------------------|------------------------|---|------------------------|
| Balance, December 31, 2007 | 42,883 | \$ 429 | \$ 257,982 | \$ (177,313) | \$ (7,087) | \$ 74,011 |
| Comprehensive income (loss) | | | | 8,728 | (416) | 8,312 |
| Dividends declared | | | (28,074) | | | (28,074) |
| Stock-based compensation costs | | | 4,605 | | | 4,605 |
| Purchase of convertible bond call options net of tax benefits of \$803 | | | (19,628) | | | (19,628) |
| Sale of common stock warrants | | | 9,852 | | | 9,852 |
| Surrender of 266 shares to cover withholding taxes on stock-based compensation | | | (3,321) | | | (3,321) |
| Issuance of shares of common stock pursuant to stock plans, \$.01 par | 744 | 7 | 937 | | | 944 |
| Balance, September 30, 2008 | 43,627 | \$ 436 | \$ 222,353 | \$ (168,585) | \$ (7,503) | \$ 46,701 |

See Notes to Consolidated Financial Statements

Table of Contents

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

| | Nine Months Ended | |
|--|--------------------------|-----------------|
| | September 30, | |
| | 2008 | 2007 |
| Cash Flows from Operating Activities: | | |
| Net income | \$ 8,728 | \$ 23,781 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 54,391 | 53,583 |
| Loss on disposal of assets, net | 763 | 137 |
| Gain on sale of long-term investments | | (152) |
| Loss on impairment of long-term investments | 255 | |
| Amortization of debt issuance costs and original issue discount | 1,835 | 1,586 |
| Stock-based compensation | 5,828 | 5,269 |
| Deferred taxes | 6,662 | |
| Other non-cash expenses | 97 | 394 |
| Changes in components of assets and liabilities: | | |
| Accounts receivable and other current assets | 731 | (510) |
| Materials and supplies | (255) | (1,858) |
| Accounts payable and other current liabilities | (6,107) | (6,589) |
| Deferred charges and other assets | (2,455) | (208) |
| Other deferred credits | (2,274) | 2,911 |
| Net cash provided by operating activities | 68,199 | 78,344 |
| Cash Flows from Investing Activities: | | |
| Investment in construction and capital expenditures | (106,900) | (40,127) |
| Change in unsettled construction and capital expenditures | 7,933 | 908 |
| Purchase of short-term investments | (9,400) | (56,938) |
| Proceeds from sale of short-term investments | 10,190 | 56,938 |
| Purchase of non-current investments | (3,625) | |
| Proceeds from sale of non-current investments | 2,275 | 162 |
| Placement of funds in restricted account | (71,726) | (2,979) |
| Release of funds from escrow account | 16,891 | 2,120 |
| Net cash used by investing activities | (154,362) | (39,916) |
| Cash Flows from Financing Activities: | | |
| Repayments of long-term debt | (2,676) | (4,893) |
| Proceeds from the issuance of long-term debt | 125,000 | |
| Purchase of call options | (20,431) | |
| Sale of common stock warrants | 9,852 | |
| Debt issuance costs | (4,309) | |
| Payment of cash dividend on common stock | (27,901) | (27,487) |
| Payment of withholding taxes on stock-based compensation | (3,321) | (2,323) |
| Proceeds from issuance of common stock | 944 | 1,180 |

| | | |
|--|-----------|-----------|
| Net cash provided (used) by financing activities | 77,158 | (33,523) |
| Change in cash and cash equivalents | (9,005) | 4,905 |
| Cash and cash equivalents, beginning of period | 35,208 | 36,860 |
| | | |
| Cash and cash equivalents, end of period | \$ 26,203 | \$ 41,765 |
| | | |
| Supplemental Cash Flow Data: | | |
| Interest paid | \$ 23,897 | \$ 21,564 |
| Income taxes paid | 417 | 508 |
| | | |
| Supplemental Noncash Transactions: | | |
| Property acquired under capital leases | \$ 1,359 | \$ 51 |
| Dividend declared, but not paid | 9,386 | 9,215 |

See Notes to Consolidated Financial Statements

Table of Contents

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

1. DESCRIPTION OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Alaska Communications Systems Group, Inc., a Delaware corporation, and its Subsidiaries (the Company or ACS Group), is engaged principally in providing wireline and wireless services to its retail consumer, business, wholesale and enterprise customers in the State of Alaska and beyond 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 represent the consolidated financial position, results of operations and cash flows principally of the following entities:

Alaska Communications Systems Holdings, Inc. (ACS Holdings)

ACS of Anchorage, Inc. (ACSA)

ACS of Alaska, Inc. (ACSAK)

ACS of the Northland, Inc. (ACSN)

ACS of Fairbanks, Inc. (ACSF)

ACS Wireless, Inc. (ACSW)

ACS Long Distance, Inc. (ACSLD)

ACS Internet, Inc. (ACSI)

ACS Messaging, Inc. (ACSM)

ACS Cable Systems, Inc. (ACSC)

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. However, the Company believes the disclosures made are adequate to make the information presented not misleading. The consolidated financial statements and footnotes included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

In the opinion of management, the financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations and cash flows for all periods presented. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results of operations which might be expected for the entire year or any other interim periods.

Auction Rate Securities

On September 30, 2008, the Company had a total of \$84,722 in cash and cash equivalents, restricted cash, and non-current investments, which included approximately \$1,095 in auction rate securities (ARS), net of a \$255 provision for other-than-temporary impairment. Beginning February 13, 2008, the Company experienced failed auctions for ARS issues and at that time, ceased to purchase auction rate securities. The Company believes that the current lack of liquidity relating to ARS investments will have no impact on the ability to fund ongoing operations and growth initiatives.

The Company's ARS portfolio is comprised of 100% AAA rated investments. Although the Company has the ability to hold these investments to maturity an assessment was performed and management determined that the fair

value of these securities was other-than-temporarily impaired. The Company has recorded a loss in the Consolidated Statements of Operations of \$255 related to its ARS portfolio. The Company will reassess this conclusion and the remaining portfolio balance in future reporting periods based on several factors, including the success or failure of future auctions, possible failure of the investment to be redeemed, deterioration of the credit ratings of the investments, market risk and other factors.

Restricted cash

Under the terms of its 2005 Senior Credit Facility, the Company was required to place net proceeds from the sale of its 5.75% convertible notes due 2013 that were unapplied within 60-days of receipt into a controlled account. The use of these unapplied receipts is restricted to the funding of either the Alaska Oregon Network (AKORN) fiber investment or the acquisition of Crest Communications Corporation (Crest). Total unapplied payments at September 30, 2008 in this account were \$47,914. Additionally, at September 30, 2008, the Company had \$7,084 in escrow for the acquisition of Crest.

Table of Contents

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

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

The remaining balance of \$2,426 is in certificates of deposit as required under the terms of certain contracts to which the Company is a party. When the restrictions are lifted, the Company will transfer these funds back into its operating accounts.

Revenue Recognition

Access revenue is recognized when earned. The Company participates in access revenue pools with other telephone companies. Such pools are funded by toll revenue and/or access charges regulated by the Regulatory Commission of Alaska (RCA) within the intrastate jurisdiction and the Federal Communications Commission (FCC) within the interstate jurisdiction. Much of the interstate access revenue is initially recorded based on estimates. These estimates are derived from interim financial statements, available separations studies and the most recent information available regarding 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. At September 30, 2008 and December 31, 2007, the Company had deferred amounts of \$5,803 and \$10,993, respectively, related to its estimate of refundable revenue.

Wireless revenue is materially impacted by seasonal factors. Wireless revenue, particularly roaming revenue, declines in the winter months and increases in the summer months due to Alaska's northern latitude and the wide swing in available daylight and changes in weather patterns between summer and winter and their effect on business, tourism and subscriber calling patterns. Revenue from non-ACS customers roaming on our network increased to \$7,311 from \$6,332 for the three months ended September 30, 2008 and 2007, respectively, and to \$16,552 from \$14,043 for the nine months ended September 30, 2008 and 2007, respectively. Our wireline segment experiences similar seasonal effects, but management does not believe these effects are material.

Regulatory Accounting and Regulation

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

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 \$63,591 and \$65,271 as of September 30, 2008 and December 31, 2007, respectively, related to depreciation of the regulated telephone plant allocable to its intrastate and local jurisdictions. The Company also has a regulatory liability of \$63,885 and \$62,443 at September 30, 2008 and December 31, 2007, respectively, related to accumulated removal costs. If the Company were not following SFAS No. 71, it would have followed SFAS No. 143, *Accounting for Asset Retirement Obligations*. Consistent with industry practice, non-regulated revenues incurred by the local telephone exchange operations and non-regulated operations of the Company are not accounted for under SFAS No. 71 principles. SFAS No. 71 also requires revenue generated between regulated and non-regulated companies not be eliminated on consolidations; these revenues totaled \$10,730 and \$10,202 for the three months ended September 30, 2008 and 2007, respectively, and \$30,679 and \$28,531 for the nine months ended September 30, 2008 and 2007, respectively.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported

Table of Contents

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

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

in the Company's consolidated financial statements and the accompanying notes. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

In May 2008, Financial Accounting Standards Board (FASB) Staff Position (FSP) Accounting Principles Board (APB) No. 14-1, Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP No. APB 14-1) was issued. FSP No. APB 14-1 states that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14 and that issuers of such instruments should account separately for the liability and equity components of the instruments in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This opinion is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008, which corresponds to the Company's fiscal year beginning January 1, 2009, and must be applied retrospectively to all periods presented. Early adoption is prohibited. The Company is currently evaluating the impact the adoption of FSP No. APB 14-1 will have on its consolidated financial statements, but expects to record higher interest expense related to its senior convertible notes beginning in fiscal year 2009.

2. COMPONENTS OF COMPREHENSIVE INCOME (LOSS)

The following table describes the components of comprehensive income (loss), net of tax, for the three and nine months ended September 30, 2008 and 2007, respectively:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 2,044 | \$ 10,300 | \$ 8,728 | \$ 23,781 |
| Minimum pension liability adjustment | 52 | 131 | 156 | 394 |
| Interest rate swap marked to market | (238) | (9,292) | (572) | (5,717) |
| Auction rate securities temporary impairment | 64 | | | |
| Total comprehensive income (loss) | \$ 1,922 | \$ 1,139 | \$ 8,312 | \$ 18,458 |

3. FAIR VALUE MEASUREMENTS

SFAS No. 157

SFAS No. 157, Fair Value Measurements defines fair value, establishes a framework for measuring fair value and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS No. 157 also expands financial statement disclosures about fair value measurements. On February 12, 2008, the FASB issued FSP No. FAS 157-2, which delays the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company elected a partial deferral of SFAS No. 157 under the provisions of FSP No. FAS 157-2 related to the measurement of fair value used when evaluating goodwill, other intangible assets, wireless licenses and other long-lived assets for impairment and valuing asset retirement obligations and liabilities for exit or disposal activities. The Company is currently evaluating the impact of FSP No. FAS 157-2 on the financial statements. The impact of partially adopting SFAS No. 157 effective January 1, 2008 was not material to the Company's financial statements.

Fair Value Measurements on a Recurring Basis

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. The Company's assessment of the significance of a particular input to the fair value

measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy.

Table of Contents

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

3. FAIR VALUE MEASUREMENTS (Continued)

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2008:

| | Fair Value Measurement at Reporting Date Using | | | |
|--|---|---|--|--|
| | Total | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| Assets: | | | | |
| Non-current investments in auction rate securities | \$ 1,095 | \$ | \$ | \$ 1,095 |
| Liabilities: | | | | |
| Interest Rate Swaps | \$(10,150) | \$ | \$(10,150) | \$ |

The following table presents the reconciliation disclosures about fair value measurements at September 30, 2008 using significant unobservable inputs (Level 3).

| | Rate Securities |
|---|----------------------------|
| Beginning balance, January 1, 2008 | \$ |
| Total gains or losses (realized / unrealized) | |
| Included in earnings | (255) |
| Purchases, issuances and settlements | 1,350 |
| Ending balance, September 30, 2008 | \$ 1,095 |

| | | |
|--|----|-----|
| The amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2008 | \$ | 255 |
|--|----|-----|

Non-current investments consist of auction rate securities that have maturity dates greater than one year from September 30, 2008. The investments in auction rate securities are included in Level 3 as no active market or significant other observable inputs exist. The Company assigned a value to its ARS portfolio by reviewing the value assigned to similar securities by brokerages, relative yields, and assessing credit risk. An assessment was also done in which management determined that the securities were other-than-temporarily impaired and a charge was taken to the income statement of \$255.

Included in Liabilities are derivative contracts, comprised of interest rate swaps, that are valued using models based on readily observable market parameters for all substantial terms of the derivative contracts and thus are classified within Level 2.

Fair Value Measurements on a Nonrecurring Basis

As permitted by FSP 157-2, ACS elected to defer the fair value measurement disclosure of nonfinancial assets including goodwill, wireless licenses, long-lived assets and intangible assets in the determination of impairment under SFAS No. 142 or SFAS No. 144, and asset retirement obligations initially measured at fair value under SFAS No. 143 *Accounting for Asset Retirement Obligations*. When adopted, the Company does not expect the standard to have a material impact on the financial statements.

SFAS No. 159

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115* (SFAS No. 159), permits but does not require the measurement of financial instruments and certain other items

Table of Contents

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

3. FAIR VALUE MEASUREMENTS (Continued)

at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. As the Company did not elect to fair value any of our financial instruments under the provisions of SFAS No. 159, the adoption of this statement effective January 1, 2008 did not have an impact on the Company's financial statements.

4. ASSET RETIREMENT OBLIGATION

The Company accounts for asset retirement obligations that are contingent on future events in accordance with Financial Interpretation Number (FIN) 47, *Accounting for Conditional Asset Retirement Obligations*. FIN 47 was effective for the Company on December 31, 2005, and required it to recognize asset retirement obligations which are conditional on a future event. Uncertainty about the timing or settlement of the obligation is factored into the measurement of the liability. The Company has a regulatory liability of \$63,885 and \$62,443 at September 30, 2008 and December 31, 2007, respectively, related to accumulated removal costs for its local telephone subsidiaries. Consistent with the industry, the Company follows SFAS No. 71, for asset retirement obligations associated with its regulated telephone plant. The Company's assets are pooled and the depreciable lives set by the regulators include a removal component which, in effect, accounts for the cost of removal. Non-regulated operations of the Company are accounted for under the principles of SFAS No. 143 and FIN 47 for which the Company has recorded a retirement obligation of \$1,552 and \$1,411 and an associated asset of \$946 and \$873, as of September 30, 2008 and December 31, 2007, respectively. These costs were recorded as a result of the Company's estimated obligation related to the removal of certain cell sites at the end of their operating lease term, adjusted for accretion over the life of the lease.

The following table outlines the changes in the accumulated retirement obligation liability for our non-regulated operations:

| | |
|------------------------------------|----------|
| Balance, January 1, 2007 | \$ 1,171 |
| Asset retirement obligation | 143 |
| Accretion expense | 99 |
| Settlement of lease obligations | (2) |
| | |
| Balance, December 31, 2007 | \$ 1,411 |
| Asset retirement obligation | 91 |
| Accretion expense | 87 |
| Settlement of lease obligations | (37) |
| | |
| Ending Balance, September 30, 2008 | \$ 1,552 |

5. LONG-TERM OBLIGATIONS

Long-term obligations consist of the following at September 30, 2008 and December 31, 2007, respectively:

| | September 30, 2008 | December 31, 2007 |
|--|-----------------------------------|----------------------------------|
| 2005 senior credit facility term loan | \$ 425,889 | \$ 427,900 |
| 5.75% convertible notes due 2013 | 125,000 | |
| Capital leases and other long-term obligations | 5,790 | 5,096 |
| | 556,679 | 432,996 |

| | | | | |
|---|----|---------|----|---------|
| Less current portion | | (649) | | (780) |
| Long-term obligations, net of current portion | \$ | 556,030 | \$ | 432,216 |

Table of Contents

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

5. LONG-TERM OBLIGATIONS (Continued)

The aggregate maturities of long-term obligations for each of the five years and thereafter subsequent to September 30, 2008 are as follows:

| | |
|--------------------------------|-------------------|
| 2008 (October 1 - December 31) | \$ 156 |
| 2009 (January 1 - December 31) | 666 |
| 2010 (January 1 - December 31) | 737 |
| 2011 (January 1 - December 31) | 820 |
| 2012 (January 1 - December 31) | 426,792 |
| 2013 (January 1 - December 31) | 125,644 |
| Thereafter | 1,864 |
| | \$ 556,679 |

On April 8, 2008 the Company closed the sale of \$125,000 aggregate principal amount of its 5.75% convertible notes due March 1, 2013. The notes were sold in a private placement pursuant to Rule 144A under the Securities Act of 1933.

The notes are unsecured obligations of the Company, subordinate to its obligations under its senior credit facility, will pay interest semi-annually in arrears on March 1 and September 1 of each year and will be convertible upon satisfaction of certain conditions. Upon conversion, holders will receive an amount in cash, shares of ACS common stock or a combination of cash and shares of ACS common stock. The notes are guaranteed by substantially all of the Company's existing subsidiaries. Holders of the notes will have the right to require the Company to repurchase all or some of their notes at 100% of their principal, plus any accrued interest, upon the occurrence of certain events. The Company also entered into a registration rights agreement with the initial purchasers of the notes. Under the registration rights agreement, the Company is obligated under certain circumstances to file a shelf registration statement under the Securities Act related to the resale of the notes and the common stock issuable upon conversion of the notes. If such registration statement is required and is not filed, or does not become effective within specified time periods, the Company will be required to pay additional interest to holders of the notes.

Concurrent with the issuance of the notes, the Company entered into convertible note hedge transactions with an affiliate of one of the initial purchasers and certain other financial institutions for the purpose of reducing the potential dilution to common stockholders. If the Company is required to issue shares of its common stock upon conversion of the notes, the Company has the option of receiving up to 9,266 shares of its common stock when the price is between \$12.90 and \$16.42 per share upon conversion. The Company entered into warrant transactions with the same counterparties whereby the financial institutions have the option of receiving up to the same number of shares of the Company's common stock when the price exceeds \$16.42 per share upon conversion. The convertible note hedge had a cost of \$20,431 and has been accounted for as an equity transaction in accordance with Emerging Issues Task Force (EITF) No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*. Tax benefits of \$422 and \$803 were recorded for the three months and nine months ended September 30, 2008, respectively, as an offset to the hedge. All future tax benefits from the deduction related to the purchase of the call option, as part of the convertible note hedge transaction, will be recorded to additional paid in capital over the term of the hedge transaction. The Company received proceeds of \$9,852 related to the sale of the warrants, which has also been classified as equity because they meet all of the equity classification criteria within EITF No. 00-19. Further, as described in Note 1 Description of Company and Summary of Significant Accounting Policies, adoption of FSP No. APB 14-1 will require us to record higher interest expense related to the notes beginning in fiscal year 2009.

The call options purchased and warrants sold contemporaneously with the sale of the convertible notes are equity contracts that meet the paragraph 11(a) scope exception of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133), and hence do not need to be marked-to-market through earnings. In addition, since the call option and warrant transactions are accounted for as equity transactions, the payment associated with the purchase of the call options and the proceeds received from the issuance of the warrants were recorded in additional paid-in capital in stockholders' equity as separate equity transactions.

Table of Contents

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

5. LONG-TERM OBLIGATIONS (Continued)

The Company received net proceeds from the offering of \$110,112 after underwriter fees, the convertible note hedge, proceeds from the warrant and other associated costs. Net proceeds were primarily used by the Company to partially fund the construction of its AKORN fiber and to purchase Crest.

Each \$1,000 principal of the notes will initially be convertible unto 77.5014 shares of the Company's common stock, which is the equivalent of \$12.90 per share, subject to adjustment upon the occurrence of specified events set forth under the terms of the note. Upon conversion, subject to certain covenants under its existing credit facility, the Company intends to pay the holders the cash value of the applicable number of shares of its common stock, up to the principal amount of the note. Amounts in excess of the principal balance may be paid in cash or in stock at the Company's option. Holders may convert their notes, at their option, at any time prior to the close of business on the business day immediately preceding the maturity date for the notes under the following circumstances:

- (1) during any fiscal quarter after the fiscal quarter ended September 30, 2008 (and only during any such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the conversion price of the notes on the applicable trading day;
- (2) during the five scheduled trading day period after any five consecutive trading-day period (the measurement period) in which the trading price per \$1,000 principal amount of the notes for each day of the measurement period was less than the 98% of the product of the last reported sale price of the Company's common stock and the conversion rate of the notes on each such day; or
- (3) upon the occurrence of specified corporate transactions described in the indenture governing the notes.

In addition, holders may also convert their notes at their option at any time beginning on November 1, 2012, and ending at the close of business on the second scheduled trading day immediately preceding the maturity date for the notes, without regard to the foregoing circumstances.

Holders who convert their notes, in connection with a change of control, may be entitled to a make-whole premium in the form of an increase in the conversion rate. In addition, upon a change in control, liquidation, dissolution or de-listing, the holders of the notes may require the Company to repurchase for cash all or any portion of their notes for 100% of the principal amount plus accrued and unpaid interest. As of September 30, 2008, none of the conditions allowing holders of the notes to convert, or requiring the Company to repurchase the notes, had been met. The Company may not redeem the notes prior to maturity.

While it is the Company's intent to settle the principal portion of this debt in cash, under the provisions of, EITF No. 04-08, *The Effect of Convertible Instruments on Diluted Earnings per Share*, the Company must use the "if converted" method set forth in SFAS No. 128, *Earnings per Share*, in calculating the diluted earnings per share effect of the assumed conversion of our contingently convertible debt. Under the "if converted" method, the after tax effect of interest expense related to the convertible securities is added back to net income, and the convertible debt is assumed to have been converted in to common stock at the earlier of the debt issuance date or the beginning of the period.

Also in accordance with SFAS No. 128, the warrants sold in connection with the hedge transaction will have no impact on earnings per share until the Company's share price exceeds \$16.422. Prior to exercise, the Company will include the effect of additional shares that may be issued using the "treasury stock" method. The call options purchased as part of the hedging transaction are anti-dilutive and therefore will have no effect on earnings per share.

6. EARNINGS PER SHARE

Earnings per share are based on the weighted average number of shares of common stock and dilutive potential common share equivalents outstanding. Basic earnings per share includes no dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of an entity. The Company includes convertible notes issued therewith using the "if converted" method as described above in Note 5 Long Term

Table of Contents

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

6. EARNINGS PER SHARE (Continued)

Obligations . The Company includes the dilutive impact of stock options and the warrants sold in connection with its convertible debt based on the treasury stock method. Potential common share equivalents, which consisted of options, restricted stock and performance share units granted to employees, and deferred shares granted to directors resulted in dilutive earnings per share for the three months ended September 30, 2008. Excluded from the calculation were 562 options and stock-settled stock appreciation rights (SSARs) which were out-of-the money and therefore anti-dilutive at September 30, 2008. No shares were anti-dilutive at September 30, 2007. Also excluded from the calculation were shares related to the Company s convertible debt which were anti-dilutive for the three and nine month periods ending September 30, 2008.

Earnings per share for the three and nine months ended September 30, 2008 was as follows:

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Numerator net income | \$ 2,044 | \$ 10,300 | \$ 8,728 | \$ 23,781 |
| Denominator weighted average shares outstanding: | | | | |
| Basic shares | 43,603 | 42,812 | 43,302 | 42,649 |
| Dilutive impact of restricted stock, options and deferred shares | 825 | 1,347 | 1,004 | 1,536 |
| Dilutive shares | 44,428 | 44,159 | 44,306 | 44,185 |
| Earnings per share: | | | | |
| Basic | \$ 0.05 | \$ 0.24 | \$ 0.20 | \$ 0.56 |
| Diluted | \$ 0.05 | \$ 0.23 | \$ 0.20 | \$ 0.54 |

7. STOCK INCENTIVE PLANS*SFAS No. 123(R), Share-Based Payment*

Total compensation cost for share-based payments was \$5,618 and \$5,269, for the nine months ended September 30, 2008 and 2007, respectively.

Equity Compensation Granted to Chief Executive Office and other Executive Officers

On June 6, 2008, the Company s compensation committee granted an aggregate of 131 performance share units (PSUs) to certain executives under the 1999 Stock Incentive Plan. These performance based awards expire on December 31, 2009 if their vesting terms have not been met. The PSUs awarded are conditioned on the participant remaining employed by or in the service of the Company from the date of the Agreement through the time of vesting. Upon vesting, the PSUs convert on a one-to-one ratio into common stock.

Compensation expense associated with outstanding performance share units is recorded over the estimated performance period which would likely result in the vesting of the awards. The amount of expense recorded each period is dependent upon our estimate of the number of shares that will ultimately be issued. As the ultimate payout of these awards is subject to the approval of the compensation committee, the awards are being re-measured at each reporting period end until such time as they are vested.

In September 2008, the Company entered into an amended and restated employment agreement with an executive officer. Under the agreement, the Company granted the executive 100 fully vested restricted stock unit equivalents (RSUEs). These RSUEs are required to be settled in shares of the Company s common stock on a one-for-one basis on

July 31, 2009, unless required stockholder approval is not obtained, in which case they will be settled in cash. When settled, the Company will pay cash dividend equivalents on any and all dividends declared on shares of the Company's common

Table of Contents

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

7. STOCK INCENTIVE PLANS (Continued)

stock from September 1, 2008 through July 31, 2009. The Company will account for these RSUEs as a liability, re-measured at each reporting period, until the Company is able to settle these shares in the Company's common stock. The Company also granted the executive 500 stock-settled stock appreciation rights. The SSARs have a term of five years and include tiered vesting through April 2009. The Company accounts for the SSARs in the same manner as options using a Black-Scholes model for valuation. In addition, the Company awarded the executive 131 performance share units to that will vest under the same terms and conditions listed above on the officer PSUs. The performance period for these awards commenced on August 1, 2008, and ends on December 31, 2009.

The following table provides certain information as to the Company's assumptions in accounting for its share-based compensation: The Company awarded SSARs in 2008 to an executive officer as part of an amended and restated employment agreement and has assumed no forfeiture as the SSARs will vest during the term of the employment agreement.

| | 2008 | 2007 |
|---|-------------|-------------|
| Stock Options and SSARs: | | |
| Risk free rate | 2% | |
| Dividend yield | 6.80% | |
| Expected volatility factor | 32.62% | |
| Expected option life (years) | 3.32 | |
| Restricted stock grants and PSUs: | | |
| Risk free rate | 2.00%-2.25% | 4.75%-5.25% |
| Quarterly dividend | \$ 0.215 | \$ 0.215 |
| Expected annual forfeiture rate | 0%-4.47% | 4.47% |
| <i>Options and Restricted Stock Outstanding</i> | | |
| <i>Stock Options and SSARs</i> | | |

Proceeds from the exercise of stock options for the nine months ended September 30, 2008 were \$643. Information on outstanding options under the plan for the nine months ended September 30, 2008 is summarized as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Life | Aggregate Intrinsic Value |
|-----------------------------------|------------------------|--|--|---------------------------------|
| Outstanding, January 1 | 1,160 | \$ 5.27 | | |
| Granted | 500 | 12.56 | | |
| Exercised | (531) | 4.68 | | |
| Canceled or expired | (12) | 11.01 | | |
| Outstanding at September 30, 2008 | 1,117 | 8.75 | 4.88 | \$ 4,169 |
| Exercisable at September 30, 2008 | 459 | \$ 10.00 | 4.84 | \$ 1,198 |

Table of Contents

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

7. STOCK INCENTIVE PLANS (Continued)

Select information on equity instruments under the plan for the nine months ended September 30, 2008 and 2007 follows:

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | September 30, | |
| | 2008 | 2007 |
| Weighted-average grant-date fair value of equity instruments granted | \$ 7.21 | \$11.91 |
| Total fair value of shares vested during the period | \$6,545 | \$4,766 |
| Total intrinsic value of options exercised | \$4,065 | \$2,035 |

Restricted Stock and PSUs

Restricted stock and PSU grants outstanding, all of which are unvested at September 30, 2008 are as follows:

| | Number of Shares | Weighted Average Fair Value |
|-----------------------------------|---------------------|--------------------------------------|
| Outstanding at January 1, 2008 | 1,296 | \$ 11.07 |
| Granted | 762 | 10.87 |
| Vested | (578) | 10.21 |
| Canceled or expired | (74) | 12.11 |
| Outstanding at September 30, 2008 | 1,406 | \$ 11.26 |

Unamortized stock-based payment and the weighted average expense period at September 30, 2008, are as follows:

| | Unamortized Expense | Average Period to Expense (years) |
|---------------------------|------------------------|--|
| Stock options and SSARs | \$ 459 | 0.6 |
| Restricted stock and PSUs | 9,754 | 2.7 |
| Total | \$ 10,213 | 2.6 |

8. RETIREMENT PLANS

Pension benefits for substantially all of the Company's employees are provided through the Alaska Electrical Pension Plan (AEPP). The Company pays a contractual hourly amount based on employee classification or base compensation. As a multi-employer defined benefit plan, the accumulated benefits and plan assets are not determined for, or allocated separately to, the individual employer. The Company also provides a 401(k) retirement savings plan covering substantially all of its employees.

The Company has a separate defined benefit plan that covers certain employees previously employed by Century Telephone Enterprise, Inc. (CenturyTel Plan). This plan was transferred to the Company in connection with the acquisition of CenturyTel, Inc.'s Alaska properties. Existing plan assets and liabilities of the CenturyTel Plan were transferred to the ACS Retirement Plan on September 1, 1999. Accrued benefits under the ACS Retirement Plan were determined in accordance with the provisions of the CenturyTel Plan. Upon completion of the transfer to the

Company, covered employees ceased to accrue benefits under the plan. On November 1, 2000, the ACS Retirement Plan was amended to conform early retirement reduction factors and various other terms to those provided by the AEPP. As a result of this amendment, prior service cost of \$1,992 was recorded and will be amortized over the expected service life of the plan participants at the date of the amendment. The Company uses the traditional unit credit method for the determination of

Table of Contents

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

8. RETIREMENT PLANS (Continued)

pension cost for financial reporting and funding purposes and complies with the funding requirements under the Employee Retirement Income Security Act of 1974 (ERISA). The Company uses a December 31 measurement date for the plan. The Company made no contributions to the plan in the nine months ended September 30, 2008. In September 2007, a contribution of \$300 was made to the 2006 plan year.

The following table represents the net periodic pension expense for the ACS Retirement Plan for the three and nine months ended September 30, 2008 and 2007:

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Interest cost | \$ 202 | \$ 185 | \$ 607 | \$ 587 |
| Expected return on plan assets | (258) | (238) | (774) | (746) |
| Amortization of loss | 37 | 80 | 111 | 241 |
| Amortization of prior service cost | 51 | 51 | 153 | 153 |
| Net periodic pension expense | \$ 32 | \$ 78 | \$ 97 | \$ 235 |

9. BUSINESS SEGMENTS

Our segments and their principal activities consist of the following:

Wireline Wireline provides communication services including next generation Internet Protocol (IP) network services, voice, broadband and data, network access, long distance and other services to consumers, carriers, business and government customers.

Wireless Wireless products and services include voice and data products and other value-added services and equipment sales.

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

The following table illustrates selected financial data for each segment as of and for the three months ended September 30, 2008:

| | Wireline | Wireless | All Other | Eliminations | Total |
|---------------------------------|-----------------|-----------------|------------------|---------------------|--------------|
| Operating revenues | \$ 67,361 | \$ 39,230 | \$ 5,551 | \$(10,820) | \$101,322 |
| Intersegment revenue | 15,355 | 644 | 5,551 | | 21,550 |
| Eliminated intersegment revenue | (5,261) | (8) | (5,551) | | (10,820) |
| Income (loss) before income tax | (48) | 11,826 | (8,004) | | 3,774 |
| Income tax (expense) benefit | 1,048 | (5,163) | 2,385 | | (1,730) |
| Net income (loss) | 1,001 | 6,663 | (5,620) | | 2,044 |
| Total assets | 557,488 | 238,585 | 15,149 | (48,145) | 763,077 |
| Capital expenditures | 31,806 | 4,058 | 2,214 | | 38,078 |

Table of Contents

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

9. BUSINESS SEGMENTS (Continued)

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

| | Wireline | Wireless | All Other | Eliminations | Total |
|---------------------------------|-----------------|-----------------|------------------|---------------------|--------------|
| Operating revenues | \$ 67,696 | \$ 37,168 | \$ 2,328 | \$(6,638) | \$ 100,554 |
| Intersegment revenue | 13,800 | 712 | 2,328 | | 16,840 |
| Eliminated intersegment revenue | (4,301) | (9) | (2,328) | | (6,638) |
| Income (loss) before income tax | 4,414 | 11,878 | (5,822) | | 10,470 |
| Income tax (expense) benefit | (1,729) | (4,863) | 6,422 | | (170) |
| Net income | 2,686 | 7,015 | 599 | | 10,300 |
| Total assets | 379,727 | 163,628 | 2,887 | | 546,242 |
| Capital expenditures | 8,614 | 2,877 | 4,765 | | 16,256 |

The following table illustrates selected financial data for each segment as of and for the nine months ended September 30, 2008:

| | Wireline | Wireless | All Other | Eliminations | Total |
|---------------------------------|-----------------|-----------------|------------------|---------------------|--------------|
| Operating revenues | \$ 196,284 | \$ 108,204 | \$ 14,437 | \$(26,471) | \$ 292,454 |
| Intersegment revenue | 40,761 | 1,952 | 14,437 | | 57,150 |
| Eliminated intersegment revenue | (12,007) | (27) | (14,437) | | (26,471) |
| Income (loss) before income tax | 3,715 | 32,533 | (20,914) | | 15,334 |
| Income tax (expense) benefit | 1,053 | (13,680) | 6,021 | | (6,606) |
| Net income (loss) | 4,769 | 18,853 | (14,894) | | 8,728 |
| Total assets | 557,488 | 238,585 | 15,149 | (48,145) | 763,077 |
| Capital expenditures | 91,183 | 10,662 | 6,505 | | 108,350 |

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

| | Wireline | Wireless | All Other | Eliminations | Total |
|---------------------------------|-----------------|-----------------|------------------|---------------------|--------------|
| Operating revenues | \$ 193,907 | \$ 102,475 | \$ 9,175 | \$(18,879) | \$ 286,678 |
| Intersegment revenue | 36,263 | 1,972 | 9,175 | | 47,410 |
| Eliminated intersegment revenue | (9,670) | (34) | (9,175) | | (18,879) |
| Income (loss) before income tax | 6,204 | 34,582 | (16,730) | | 24,056 |
| Income tax (expense) benefit | (2,779) | (14,102) | 16,606 | | (275) |
| Net income (loss) | 3,426 | 20,480 | (125) | | 23,781 |
| Total assets | 379,727 | 163,628 | 2,887 | | 546,242 |
| Capital expenditures | 19,209 | 14,147 | 6,955 | | 40,311 |

10. 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 \$350 at September 30, 2008 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.

11. SUBSEQUENT EVENTS

On April 1, 2008, the Company and Crest entered into a Stock Purchase Agreement (the "Agreement"), pursuant to which the Company purchased Crest. All regulatory approvals were received and the Company closed the transaction on October 30, 2008, acquiring Crest free of debt for cash consideration of approximately \$70,000. The Company and

Crest

Table of Contents

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

11. SUBSEQUENT EVENTS (Continued)

have made customary representations and warranties and covenants in the Agreement. The Company has deposited approximately \$9,655 of the \$70,000 of cash consideration in an escrow account to be used for potential claims of misrepresentations, breach of warranties or covenants or for other indemnifications during the first eighteen months following the closing.

Table of Contents

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

Forward Looking Statements and Analysts' Reports

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

our strongly competitive environment, which comprises national and local wireless and wireline facilities-based competitors;

our ability to complete, manage, integrate, market, maintain and attract sufficient customers to our AKORN fiber facility and our ability to develop attractive integrated products and services making use of the facility;

our ability to fully integrate the Crest Northstar fiber facility with AKORN and the ACS network generally such that we realize the synergies available;

our ability to generate sufficient earnings and cash flows to continue to make dividend payments to our stockholders and comply with the restrictive covenants of our debt obligations;

changes in revenue from Universal Service Funds (USF);

rapid technological developments and changes in the telecommunications industries;

changes in revenue resulting from regulatory actions affecting intercarrier compensation;

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

occurrence of widespread or lengthy failures of our system or network cables, particularly our non-redundant systems, including our existing primary capacity on the Northstar cable, the failure of which would cause significant delays or interruptions of service and/or loss of customers and may adversely affect our investment in Crest;

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

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

our ability to bundle our products and services;

changes in the demand for our products and services and new competitive entrants;

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

governmental and public policy changes;

continuing uncertainty arising out of our assessment of the effectiveness of our internal controls over financial reporting as of December 31, 2007;

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

the matters described under *Item 1A Risk Factors* in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 and subsequent Quarterly Reports on Form 10-Q.

In light of these risks, uncertainties and assumptions, you should not place undue reliance on any forward-looking statements. Additional risks that we may currently deem immaterial or that are not currently known to us could also cause

Table of Contents

the forward-looking events discussed in this Form 10-Q or our other reports not to occur as described. Except as otherwise required by applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Form 10-Q.

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

Unless the context indicates otherwise, all references in this Form 10-Q to we, our, ours, us, the Company ACS refer to Alaska Communications Systems Group, Inc. and its consolidated subsidiaries.

Overview

We believe we are the leading provider of integrated communications services in Alaska. Our wireline business comprises one of the most expansive end-to-end Internet Protocol (IP) networks in Alaska and the largest local exchange carrier network in the state. We believe our wireless business comprises the most extensive, reliable wireless network in Alaska and the only Alaska wireless network with third-generation data transmission capabilities.

The sections that follow provide information about important aspects of our operations and investments and include discussions of our results of operations, financial condition and sources and uses of cash. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information we use in evaluating performance and allocating resources. We also monitor the state of the economy in general. In doing so, we compare Alaskan economic activity with broader economic conditions. In general, we believe that the Alaskan telecommunications market as well as general economic activity in Alaska, differs in important ways from the broader U.S. economy. These differences include, among others, the cost of long-haul telecommunications bandwidth, military activity, local customer preferences, median personal income, average usage of Internet technology, unemployment levels, housing activity, activity in the oil and gas markets, tourism, and local political activity.

Our results of operations, financial position and sources and uses of cash in the current and future periods continue to reflect our focus on the following strategic imperatives:

Emphasis on Top-Line Growth: We emphasize revenue growth as well as growth in net cash provided by operating activities. We devote more resources to higher growth markets such as wireless, including wireless data, wireline broadband connections, including our long-haul fiber investment connecting our network to the lower 48, as well as expanded strategic services to business markets, rather than to the traditional wireline voice market.

Investment with Discipline: We focus on gaining market share in those markets that contain high revenue producing customers. In our wireline business, we focus on deploying and selling broadband connections in each market covered by our network. We have targeted investment in deploying high-speed fiber connectivity in and between Alaska's urban centers. We have increasingly targeted carrier and enterprise customers. Revenues for the three months ended September 30, 2008 from these customers grew 36.8% compared to the prior year, primarily driven by sales of advanced IP services and increases in revenues from agreements with carriers to terminate their Alaskan long-distance traffic. We have directed resources towards offering wireless plans that encourage customer adoption of large monthly-minute postpaid plans and unlimited postpaid plans. We also promote an unlimited data and text message package. These investments have been made, in part, to maintain a competitive position against a new national wireless provider market entrant.

Profitability Improvement: We seek to increase operating income and margins. Supporting this goal, our capital spending continues to be directed toward growth markets. High-speed EV-DO and cutting-edge data services, deployment of our AKORN fiber facility coupled with the complimentary purchase of Crest, as well as expanded services to enterprise customers, including Metro Ethernet, are examples of initiatives designed to

tap high growth markets. As a result of our investment in AKORN, we expect 2008 capital expenditures to be higher than 2007 levels. In addition, we expect additional capital expenditures to support the growth of our wireless network and enhance its reliability and data transmission speeds through an upgrade to EV-DO, Rev A technology. We expect to target these capital expenditures based on feedback from large customers seeking high-speed wireless data coverage, particularly in Alaska's North Slope oil fields.

Table of Contents

Process Improvement: While focusing resources on revenue growth and market share gains, we continually challenge our management team and employees at all levels to lower expenses through process improvements. We expect to invest in technology-assisted process improvement, including self-service initiatives. We expect these efforts, such as call center routing improvements, deploying self-pay kiosks, and customer service tools, to improve our cost structure and maintain or improve operating income margins. As a result of past successes, we have been able to serve more customers while maintaining our workforce at or below prior levels.

Pay for Performance: We embrace a culture of urgency and accountability. We establish goals for all of our employees that are tied to the imperatives described above and tie compensation to performance whenever practicable.

Revenue Sources by Segment

Wireline

We provide advanced IP network services, voice, data, broadband, network access and long distance services to consumers, carriers, businesses and government customers throughout Alaska and to and from Alaska. We provide telephone and high speed Internet services to consumers in our wireline footprint. Our high-speed data network relies on advanced packet-based MPLS technology. Our MPLS network combined with our Metro Ethernet service, which we market to medium and large businesses, government customers and carriers, offers our customers scalable, high-speed data and customized information technology products and services, as well as Internet connectivity. To complete our robust wireline fiber network, we expect to fully integrate Crest's Alaska Northstar fiber facility into our network and commercially deploy in early 2009 our new state-of-the-art AKORN undersea fiber optic cable connecting Alaska with the lower 48 states. Our wireline revenues for the three and nine months ended September 30, 2008 were \$62.1 million and \$184.3 million, respectively, representing approximately 61.3% and 63.0%, respectively, of our aggregate revenues.

Wireless

Our wireless segment provides facilities-based voice and data services statewide. We operate the only third-generation wireless network in Alaska.

We provide wireless voice and data services across an extensive statewide 1xRTT CDMA and EV-DO wireless network. In addition, through roaming agreements with major U.S. and Canadian carriers, we provide our customers a range of services and coverage throughout the lower 48 states, Hawaii and Canada. Our wireless revenues for the three and nine months ended September 30, 2008 were \$39.2 million and \$108.2 million, respectively, representing approximately 38.7% and 37.0%, respectively, of our aggregate revenues.

Table of Contents**RESULTS OF OPERATIONS**

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

Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**Operating Revenues****Wireline**

The following table summarizes wireline revenue by source for the three months ended September 30, 2008 and 2007.

| | Three Months ended September 30, | | |
|------------------------------------|---|---------------|------------------|
| | (in thousands) | | |
| Wireline Revenue by Source: | 2008 | Change | 2007 |
| Retail | \$ 23,617 | -4.9% | \$ 24,835 |
| Wholesale | 5,244 | -12.5% | 5,994 |
| Access | 23,676 | -7.4% | 25,578 |
| Enterprise | 9,563 | 36.8% | 6,988 |
| | \$ 62,100 | -2.0% | \$ 63,395 |

Retail: Retail revenue decreased by \$1.2 million, or 4.9%, in the three months ended September 30, 2008 over September 30, 2007. The decrease was driven by a \$0.8 million decline in local exchange revenue primarily associated with residential line losses, a \$0.5 million decrease in customer premise equipment sales to businesses, \$0.2 million decline in long distance sales, and a \$0.1 million decline in dial up ISP revenue. These losses were offset, in part, by and \$0.4 million increase in revenue from our DSL subscriber base.

Wholesale: Wholesale revenues decreased by \$0.8 million, or 12.5%, in 2008 due to declines in unbundled network elements (UNE) and wholesale local revenue where lines in service declined by 30.1% annually to 30,120 as a result of the ongoing migration of lines over to cable telephony. As a result of ongoing declines in UNE and wholesale local lines, we expect that wholesale revenue will decline as a component of wireline revenue for the foreseeable future.

Access: Access revenues decreased by \$1.9 million, or 7.4%, in 2008, with the prior year performance benefiting from \$3.3 million in out of period network access, arising from settlements with the National Exchange Carrier 's Association (NECA), compared to \$1.4 million in 2008. We expect that network access revenue will decline as a component of local telephone revenue for the foreseeable future due to the reduction in allocable expenses and the continued shift of voice traffic to wireless networks.

Enterprise: Enterprise revenue increased by \$2.6 million, or 36.8%, in 2008 due to \$1.4 million in revenue from the provision of virtual network facilities to lower 48 carriers for long distance voice termination, \$0.5 million from higher sales of advanced network services to large business and government customers, and an increase of \$0.6 million in point to point private line services.

Wireless

Wireless revenue increased \$2.1 million, or 5.6%, to \$39.2 million for the three months ended September 30, 2008 compared to \$37.1 million for the three months ended September 30, 2007. This increase is primarily due to the following:

growth in average subscribers of 4.7% to 149,606 from 142,866 for the three months ended September 30, 2008 and 2007, respectively;

higher phone and accessory sales in the quarter ended September 30, 2008 resulting in \$3.7 million of handset revenue compared to \$2.5 million for the quarter ended September 30, 2007; and

higher revenue from non-ACS customers roaming on our network resulting in third-party roaming revenue increasing to \$7.3 million from \$6.3 million for the quarter ended September 30, 2008 and 2007, respectively.

Table of Contents

These gains were offset, in part, by a 5.6% decline in average revenue per unit (ARPU) to \$60.79 from \$64.43 following proactive measures taken to match national price points for voice plans.

Operating Expense

Operating expense increased \$6.5 million, or 7.9%, to \$89.2 million for the three months ended September 30, 2008 from \$82.7 million for the three months ended September 30, 2007. Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

Wireline: Wireline expenses, which include local telephone, Internet, interexchange and cable systems operating costs, increased \$2.3 million, or 5.1%, for the three months ended September 30, 2008 compared to the comparable period in 2007. The increase is primarily attributable to a \$1.4 million in start up costs for our strategic long haul fiber investments, a \$1.0 million increase in long distance interstate COGS and a \$1.0 million in net non-recurring expense benefits in the prior year, including a \$1.8 million favorable settlement on a long term property tax dispute and a \$0.8 million contingent liability charge on a vendor contract. These increases were offset in part by a \$0.5 million decrease related to an amended affiliate billing and collection (B&C) agreement and a \$0.7 million decrease in labor costs.

Wireless: Wireless expense increased \$3.0 million, or 15.3%, for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. The increase is primarily attributable to an additional \$1.5 million in handset, accessory and data content expense, \$0.9 million in expense associated with backhaul costs for our expanded wireless footprint, and \$0.6 million in employee sales and service costs to support our growing customer base.

Depreciation and Amortization: Depreciation and amortization expense increased \$1.3 million, or 7.4%, for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. The change is due to accelerated depreciation of asset additions in asset classes that had previously reached their maximum depreciable lives and are now depreciating again.

Other Income and Expense: Other income and expense was a net expense of \$8.3 million in the three months ended September 30, 2008, an increase of 12.6% from the \$7.4 million in the three months ended September 30, 2007. The increase is primarily attributable to an increase in interest expense of \$2.0 million associated with our new convertible debt instrument offset, in part, by a \$0.4 million decrease in interest expense related to our 2011 notes paid which were paid in full in August of 2007, and an increase of \$0.8 million in capitalized interest on our long-term construction projects. In addition, we recorded an impairment charge on our auction rate securities of \$0.3 million.

Income Taxes: In the quarter ended September 30, 2008, we recorded a tax expense of \$1.7 million. There was no corresponding expense in 2007, other than \$0.2 million of alternative minimum tax (AMT), as prior to December 2007 we had fully reserved for the unused income tax benefit resulting from the consolidated loss we had incurred since our inception. Our estimated effective tax rate is 45.85%. At September 30, 2008, we had tax net operating loss carry forwards of \$127.3 million. Income tax expense will not involve a cash outflow, other than for AMT, until these net operating losses (NOLs) are used.

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

Table of Contents**Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007****Operating Revenues****Wireline**

The following table summarizes wireline revenue by source for the nine months ended September 30, 2008 and 2007.

| | Nine Months ended September 30, | | |
|------------------------------------|--|---------------|-------------------|
| | (in thousands) | | |
| Wireline Revenue by Source: | 2008 | Change | 2007 |
| Retail | \$ 71,163 | -3.7% | \$ 73,908 |
| Wholesale | 15,660 | -13.0% | 17,999 |
| Access | 71,581 | -3.7% | 74,331 |
| Enterprise | 25,873 | 43.7% | 17,999 |
| | \$ 184,277 | 0.0% | \$ 184,237 |

Retail: Retail revenue decreased by \$2.7 million, or 3.7%, in the nine months ended September 30, 2008. The decrease was driven by a \$2.2 million decline in local exchange revenue primarily associated with residential line losses, \$0.7 million in lower CPE sales to businesses, a \$0.6 million decline in long distance sales and a \$0.4 million decrease in dial up ISP revenue. These losses were offset, in part, by a \$1.1 million increase in revenue from our DSL subscriber base.

Wholesale: Wholesale revenues decreased by \$2.3 million, or 13.0%, in the nine months ended September 30, 2008 due to declines in UNE and wholesale local revenue which is primarily attributable to the ongoing migration of lines leased to our key competitor to cable telephony, offset in part by a negotiated increase in rates.

Access: Access revenues decreased by \$2.8 million, or 3.7%, in the nine months ended September 30, 2008. In 2008 and 2007, we benefited from a \$6.1 million and \$5.5 million, respectively, in net out-of-period settlements and net reserve releases. The 2008 out-of-period revenue included a \$5.5 million reserve release primarily related to refundable USF support while the 2007 settlement included \$5.4 million in settlements with NECA and Universal Service Administrative Company (USAC) for our cost studies. In addition, for the nine months ended September 30, 2008, high cost loop support decreasing by \$2.0 million, intrastate revenue decreasing by \$1.4 million due to lower demand driven by the continued shift of voice traffic to wireless networks, and interstate revenue decreased \$0.4 million. We expect network access revenue to decline as a component of revenue for the foreseeable future.

Enterprise: Enterprise revenue increased by \$7.9 million, or 43.7%, in the nine months ended September 30, 2008 due to \$5.3 million in revenue from the provision of virtual network facilities to lower 48 carriers for long distance voice termination, \$1.3 million from higher sales of advanced network services to large business and government customers, an increase \$0.3 million in point-to-point private line services and \$1.0 million from a capacity exchange agreement with another carrier.

Wireless

Wireless revenue increased \$5.7 million, or 5.6%, to \$108.2 million for the nine months ended September 30, 2008 compared to \$102.5 million for the nine months ended September 30, 2007. This increase is primarily due to the following:

growth in average subscribers of 5.7% to 147,428 from 139,444 for the nine months ended September 30, 2008 and 2007, respectively;

higher phone and accessory sales for the nine months ended September 30, 2008 resulting in \$8.3 million of handset revenue compared to \$6.8 million for the nine months ended September 30, 2007; and

higher revenue from non-ACS customers roaming on our network resulting in third-party roaming revenue increasing to \$16.6 million from \$14.0 million for the nine months ended September 30, 2008 and 2007, respectively.

Table of Contents

These gains were offset, in part, by a 1.9% decline in ARPU to \$60.99 from \$62.14 following proactive measures taken to match national price points for voice plans.

Operating Expense

Operating expense increased \$12.4 million, or 5.2%, to \$253.7 million for the nine months ended September 30, 2008 from \$241.3 million for the nine months ended September 30, 2007. Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

Wireline: Wireline expenses, which include local telephone, Internet, interexchange and cable systems operating cost increased \$0.9 million, or 0.7%, for the nine months ended September 30, 2008 compared to the comparable period in 2007. The decrease is primarily attributable declines of \$7.1 million in labor and \$1.1 million in an affiliate B&C charges and \$0.6 million in lower advertising costs associated with our DSL service. This decrease was offset, in part, by a \$3.7 million increase in LD interstate COGS, a \$1.3 million increase in ISP access and circuit expenses and \$2.2 million in start up costs for our strategic long haul fiber investments, a net \$1.0 million in net non-recurring expense benefits in the prior year, including a \$1.8 million favorable settlement on a long term property tax dispute and a \$0.8 million contingent liability charge on a vendor contract.

Wireless: Wireless expense increased \$10.1 million, or 18.9%, for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The increase is primarily attributable to \$3.8 million in costs associated with backhaul costs for our expanded wireless footprint, an increase of \$3.3 million in handset, accessory and data content expense, a \$2.0 million increase in employee sales and service costs to support our growing customer base and a \$0.3 million increase in regulatory surcharges.

Depreciation and Amortization: Depreciation and amortization expense increased \$0.8 million, or 1.5%, for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The change is primarily due to an increase in the number of asset classes reaching their maximum depreciable lives.

Loss on disposal of assets: In the nine months ended September 30, 2008, we recorded a loss on disposal of assets of \$0.8 million related to the termination of our satellite TV distribution agreement.

Other Income and Expense: Other income and expense was a net expense of \$23.4 million in the nine months ended September 30, 2008, an increase of 9.6% from the \$21.3 million in the nine months ended September 30, 2007. The increase is primarily attributable to an increase in interest expense of \$3.9 million associated with our new convertible debt instrument offset by a \$0.6 million decrease in interest expense related to our 2011 notes which were paid in full in August of 2007, and an increase in \$1.3 million of capitalized interest on our long-term construction projects. In addition, we recorded an impairment charge on our auction rate securities in the current period of \$0.3 million.

Income Taxes: In the nine months ended September 30, 2008, we recorded a tax expense of \$6.6 million. There was no corresponding expense in 2007, other than \$0.3 million of AMT, as prior to December 2007 we had fully reserved for the unused income tax benefit resulting from the consolidated loss incurred since our inception. Our estimated effective tax rate is 43.08%. At September 30, 2008 we had tax net operating loss carry forwards of approximately \$127.3 million. Income tax expense will not involve a cash outflow, other than for AMT, until these NOLs are used.

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

Liquidity and Capital Resources**Sources**

We have satisfied our cash requirements in the first nine months of 2008 for operations, capital expenditures and debt service primarily through cash on hand, internally generated funds and the net proceeds of our \$125.0 million convertible debt offering. For the nine months ended September 30, 2008, our net cash flows provided by operating activities were \$68.2 million. At September 30, 2008, we had approximately \$71.3 million in net working capital, approximately \$26.2 million in cash and cash equivalents and \$57.4 million in restricted cash. We also had \$45.0 million of remaining capacity under our revolving credit facility, representing 100% of available capacity.

Our 2005 senior secured credit facility contains a number of restrictive covenants and events of default, including covenants limiting capital expenditures, incurrence of debt and payment of dividends. The 2005 senior credit facility also requires that we achieve certain financial ratios quarterly and we are currently operating comfortably within their

restrictions. We have entered into a series of interest swap agreements that have effectively hedged London Inter-Bank Offered Rate (LIBOR) on our entire term loan.

Table of Contents

On April 8, 2008, we sold \$125.0 million aggregate principal amount of our 5.75% convertible notes due March 1, 2013. These notes are unsecured obligations, subordinate to our obligations under the senior credit facility, will pay interest semi-annually and will be convertible upon satisfaction of certain conditions. For further information on our issuance of these notes, see the notes to our consolidated financial statements, specifically under the heading, Note 5 Long-Term Obligations .

Uses

Our networks require the timely maintenance of plant and infrastructure. Our historical capital expenditures have been and continue to be significant. We expect especially heavy capital expenditures to be made during 2008 to complete construction of our AKORN fiber facility. Cash out flows for capital expenditures for the nine months ended September 30, 2008 were \$99.0 million. New capital acquisitions for 2008 totaled \$106.9 million of which \$74.6 million was expended on the build out of our AKORN facility. In addition, on October 30, 2008 we completed our acquisition of Crest, a company we acquired free of debt, for cash consideration of approximately \$70.0 million (for further information, please see Acquisition of Crest). We expect to make capital expenditures designed to upgrade and integrate Crest's Northstar fiber facility with our AKORN facility and intrastate fiber network. Once completed, we will operate a fully redundant, path-protected fiber ring connecting our Alaska fiber network with the greater fiber infrastructure of the lower 48. We intend to fund future capital expenditures, including our completion of the AKORN facility, with cash on hand, access to our revolving credit facility and net cash generated from operations.

Since October 28, 2004, we have paid quarterly dividends on our common stock. Based on current shares outstanding at October 20, 2008 of approximately 43.6 million shares, and our current annual dividend policy of \$0.86 per share, maintenance of our current annual dividend policy would result in \$37.5 million cash being paid to common stockholders over the next twelve months. Dividends on our common stock are not cumulative.

We believe that we will have sufficient cash on hand, cash provided by operations, and available borrowing capacity under our revolving credit facility to service our debt, pay our quarterly dividends, and fund our operations, capital expenditures and other obligations over the next 12 months. Our ability to meet such obligations will be dependent upon our future financial performance, which is, in turn, subject to future economic conditions and to financial, business, regulatory and other factors, many of which are beyond our control.

Acquisition of Crest

On April 1, 2008, the Company and Crest entered into a Stock Purchase Agreement, pursuant to which the Company would purchase Crest. All regulatory approvals were received and the Company closed the transaction on October 30, 2008, acquiring Crest free of debt for cash consideration of approximately \$70.0 million. On November 6, 2008 we had \$9.7 million of the \$70.0 million of cash consideration in an escrow account to be used for potential claims of misrepresentations, breach of warranties or covenants or for other indemnifications during the first eighteen months following the closing.

Crest's system includes an undersea fiber system of approximately 1,900 miles with cable landing facilities in Whittier, Juneau, and Valdez, Alaska, and Nedonna Beach, Oregon. The system also includes terrestrial transport components linking Nedonna Beach, Oregon to the Network Operations Control Center in Hillsboro, Oregon and collocation facilities in Portland, Oregon and Seattle, Washington. Crest has 18 employees responsible for its network, sales, regulatory compliance, and administration.

We believe that the acquisition will complement our AKORN fiber build, by providing meaningful operating efficiencies and cost synergies, by offering enterprise customers the only diverse and redundant routing of traffic between Alaska and the lower 48, by allowing management of Network Operations Control Centers in Alaska and the lower 48, and by connecting our network to Southeast Alaska. Furthermore, we believe that the acquisition will also drive incremental utilization of ACS' differentiated Alaskan terrestrial assets from Crest's customer base and allow ACS to participate in the fast-growing bandwidth market ahead of AKORN's commercial launch in the first quarter of 2009.

Legal and Regulatory Matters

We are involved in various claims, legal actions, personnel matters and regulatory proceedings arising in the ordinary course of business, and have recorded litigation reserves of \$0.4 million against certain claims and legal actions as of September 30, 2008. We believe that the disposition of these matters will not have a material adverse

effect on our consolidated financial position, results of operations or cash flows beyond the amounts already recorded. Estimates involved in developing these litigation reserves could change as these claims, legal actions and regulatory proceedings progress.

On May 1, 2008, the FCC issued an order adopting an interim emergency cap on the amount of high-cost support that competitive eligible telecommunications carriers (CETCs) may receive. Although the order includes some limited

Table of Contents

exceptions for Alaska Native regions and tribal lands, the order may nevertheless adversely affect our potential to grow future CETC revenues.

An interim cap on universal service support received by CETCs such as ACSW took effect on August 1, 2008. In the Order, the FCC adopted a limited exception to the cap for Alaska Native Regions and tribal lands that covered all ACSW's service area. The intent of the exception was to provide uncapped support for the specified underserved areas. The exception language, however, is ambiguous and not yet effective ACSW and other impacted providers have asked the FCC for clarification. It is difficult to predict how or when the Commission will make the exception available to providers such as ACSW.

Employees

As of September 30, 2008, we employed approximately 966 regular full-time employees, 14 regular part-time employees and 3 full-time temporary employees. Of these employees, approximately 77% are represented by the International Brotherhood of Electrical Workers, Local 1547 (IBEW). Management considers employee relations to be good with both the represented and non-represented workforce.

Critical Accounting Policies and Accounting Estimates

We have identified certain policies and estimates as critical to our business operations and the understanding of our past or present results of operations. For additional discussion on the application of these and other significant accounting policies, see our Form 10-K for the fiscal year ended December 31, 2007 under Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.

Recently Issued Accounting Pronouncements

In June 2008, the FASB issued FSP EITF No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. Under the FSP, unvested share-based payment awards that contain rights to receive nonforfeitable dividends (whether paid or unpaid) are participating securities, and should be included in the two-class method of computing EPS. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years, and is not expected to have a significant impact on our results of operations, financial condition or liquidity.

In May 2008, FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP No. APB 14-1) was issued. FSP No. APB 14-1 states that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of Accounting Principles Board Opinion No. 14 and that issuers of such instruments should account separately for the liability and equity components of the instruments in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This opinion is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008, which corresponds to our fiscal year beginning January 1, 2009, and must be applied retrospectively to all periods presented. We are currently evaluating the impact the adoption of FSP No. APB 14-1 will have on our consolidated financial statements, but we expect to record higher interest expense related to our senior convertible notes beginning in 2009.

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities . FAS No. 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under FAS No. 133, and how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. The statement is effective for financial statements issues for fiscal years and interim periods beginning after November 15, 2008, and we are currently reviewing the impact this will have on our results of operations, financial condition and liquidity.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (Revised) , (SFAS No. 141(R)), to replace SFAS No. 141, Business Combinations. SFAS No. 141(R) requires the use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and broadens the scope to all transactions and other events in which one entity obtains control over one or more other businesses. This statement is effective for business combinations or transactions entered into for fiscal years beginning on or after December 15, 2008. We are still evaluating the impact of SFAS No. 141(R), however, the adoption of this statement is not expected to have a material

impact on our financial position or results of operations.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of September 30, 2008, we had outstanding debt under our 2005 senior credit facility. This on-balance sheet financial instrument, to the extent it provides for variable rates of interest, exposes us to interest rate risk, with the primary interest rate risk exposure resulting from changes in LIBOR or the prime rate, which are used to determine the interest rates that are applicable to borrowings under our 2005 senior credit facility. In order to manage this risk, we have entered into a series of floating-to-fixed interest rate swap agreements that effectively fix LIBOR on the entire outstanding balance on the 2005 senior credit facility. The term of these swap agreements ranges from December 2009 through December 2011. On April 8, 2008, we sold \$125.0 million aggregate principal amount of our 5.75% convertible notes due 2013 in a private placement. The notes pay interest at a fixed rate and are subordinate to our obligations under our senior secured credit facility as well as certain hedging agreements and other secured debt available under the credit facility. For further information, see Note 5 Long-Term Obligations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Disclosure and Reporting

There were no changes to the Company's internal control over financial reporting during the quarter ended September 30, 2008, that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes to the Company's risk factors as previously disclosed in Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 and subsequently filed quarterly reports on Form 10-Q.

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

Working capital restrictions and other limitations on the payment of dividends

Our 2005 senior secured credit facility contains a number of restrictive covenants and events of default, including covenants limiting capital expenditures, incurrence of debt, and the payment of dividends. Such credit facility also requires that we maintain certain financial ratios. In addition, the Indenture governing our outstanding 5.75% convertible notes due March 1, 2013 also contains a number of restrictive covenants

Table of Contents

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits:

- 3.1 Amended and Restated Bylaws of Alaska Communications Systems Group, Inc., effective September 12, 2008. (1)
- 10.1* Amended and Restated Employment Agreement between Alaska Communications Systems Group, Inc., and Liane Pelletier entered into as of September 22, 2008. (2)
- 31.1 Certification of Liane Pelletier, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of David Wilson, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Liane Pelletier, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of David Wilson, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.

* Indicates management contract or compensatory plan or arrangement.

(1) Incorporated herein by reference to the Company's Form 8-K filed with the SEC on September 18, 2008.

(2)

Incorporated
herein by
reference to the
Company's Form
8-K filed with
the SEC on
September 26,
2008.

Table of Contents

SIGNATURES

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

Date: November 6, 2008

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

/s/ Liane Pelletier

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

/s/ David Wilson

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

31