ALASKA COMMUNICATIONS SYSTEMS GROUP INC
Form 10-K
March 14, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from to

Commission file number 000-28167

Alaska Communications Systems Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**52-2126573**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

600 Telephone Avenue Anchorage, Alaska	**99503-6091**
(Address of principal executive offices)	(Zip Code)

(907) 297-3000

(Registrant s telephone number, including area code)

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

Title of each class	**Name of each exchange on which registered**
Common Stock, Par Value $.01 per Share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ

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 þ
No o

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The aggregate market value of the shares of all classes of voting stock of the registrant held by non-affiliates of the registrant on June 30, 2006 was approximately $520 million computed upon the basis of the closing sales price of the Common Stock on that date. For purposes of this computation, shares held by directors (and shares held by any entities in which they serve as officers) and officers of the registrant have been excluded. Such exclusion is not intended; nor shall it be deemed, to be an admission that such persons are affiliates of the registrant.

As of February 26, 2007, there were outstanding 42,349,801 shares of Common Stock, $.01 par value, of the registrant.

Documents Incorporated by Reference

Portions of Registrant s definitive proxy statement for its annual stockholders meeting to be held on June 18, 2007 are incorporated by reference in Part III of this Form 10-K

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2006

Table of Contents

PART I

Item 1. Business

Forward Looking Statements and Analysts Reports

This Form 10-K 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-K under Business , Risk Factors , Management s discussion and analysis of financial condition and results of operations , and elsewhere in this Form 10-K. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by us as a result of a number of important factors. Examples of these factors include (without limitation):

- rapid technological developments and changes in the telecommunications industries;
- our competitive environment;
- changes in revenue from Universal Service Funds;
- changes in revenue resulting from regulatory actions affecting intercarrier compensation;
- regulatory limitations on our ability to change our pricing for communications services;
- possible widespread or lengthy failures of our system or network cables, particularly our non-redundant systems, including our primary fiber-link connecting Alaska and the lower 48-states, which would cause significant delays or interruptions of service and loss of customers;
- other unanticipated damage to one or more of our high capacity cables resulting from construction or digging mishaps or natural disasters;
- the possible future unavailability of Statement of Financial Accounting Standards (SFAS), No. 71, Accounting for the Effects of Certain Types of Regulation, to our wireline subsidiaries;
- our ability to bundle our products and services;
- changes in the demand for our products and services;
- changes in general industry and market conditions and growth rates;

- changes in interest rates or other general national, regional or local economic conditions;
- governmental and public policy changes;
- our ability to generate sufficient earnings and cash flows to continue to make dividend payments to our stockholders;
- the continued availability of financing in the amounts, at the terms, and subject to the conditions necessary to support our future business;
- the success of any future acquisitions;
- changes in accounting policies or practices adopted voluntarily or as required by accounting principles generally accepted in the United States; and
- the matters described under Risk Factors.

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

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.

Our Company ACS

Headquartered in Anchorage, we provide customer-focused, facilities-based, integrated telecommunications services. We operate the largest local telephone network in Alaska. We believe we offer strong growth opportunities premised on a customer-focused marketing strategy targeted at a growing customer base using products and assets matching the highest growth segments of the industry. We seek to offer our customers a one-stop-shop for their telecommunication needs, while reducing our back office costs.

We own and operate our infrastructure for local and long distance telephone, Internet, and wireless services. Currently, no other Alaskan provider owns such an infrastructure. We also operate the only statewide wireless network using code division multiple access (CDMA) technology through which we offer very high speed mobile data using third generation, or 3G, Evolution Data Optimized (EV-DO) technology. In addition, we offer satellite television through our partnership with DISH Network. Using our diverse product mix, we bundle our products to gain market share and increase our share of our customers telecommunications spending. We believe this strategy, combined with a strong financial foundation and a dividend program, provides us with a strong position for future growth.

ACS Group is a Delaware corporation, incorporated in October 1998. We began operations in May 1999 when we completed the acquisition and integration of four local telephone companies in Alaska. Each of these companies had been operating in its local market for over 50 years. Since 1999, we have built our network and service capabilities under a single brand name, Alaska Communications Systems (ACS) and as an integrated company, we have provided the leading facilities-based telecommunications services in Alaska. Using our strong ACS brand name and state of the art network, we have generated stable revenues and cash flow since 2000 and increased our market share in two of the highest growth areas of telecommunications: wireless and Internet services.

Our Market Alaska

We target our products and services at a growing customer base with strong telecommunications spending habits. For the three year period from 2003 to 2005, the average median household income in Alaska was 22.4% higher than the average in the rest of the United States, and Alaskans spent 33% more on communications services than other Americans. According to the U.S. Census Bureau, over the five years ending 2006, the Alaskan population has increased 6.0%, nearly 20% higher than the national average. Additionally, Alaska has lower-than-U.S. average wireless service penetration, which provides us with opportunities to quickly move into new markets.

We have successfully grown our retail relationships. As of December 31, 2006, we served 446,438 retail relationships. A retail relationship refers to one service provided to one customer, and therefore, a customer may, and often does, engage with us in multiple retail relationships. The following table sets forth our retail relationship growth since December 31, 2004.

	As of December 31,		
	2006	**2005**	**2004**
Local	194,815	199,341	206,209
Wireless	130,971	112,854	94,232
Internet	56,657	53,245	47,553
Long Distance	63,995	56,317	47,050
	446,438	421,757	395,044

4

Despite the further potential for growth in our market, we believe that Alaska s large geographic size and isolated markets of both major metropolitan areas and small, dense population clusters reduces the likelihood of entry by new competitors offering integrated, facilities-based services. As a result, we believe our already strong market presence will continue to contribute to our stability and growth and provide us with an advantage relative to other telecommunications markets.

Our Services At a Glance

We have provided a summary of the services we provide below. For a more detailed discussion of our services, please see, Products, Services and Revenue Sources below.

Local telephone. We provide local telephone service to approximately 253,000 access lines, representing approximately 57% of the local access lines in Alaska. We generate local telephone revenue from providing local telephone service to consumer and business customers and by providing access to our network and back office functions to other telecommunications companies. At December 31, 2006, approximately 50% of our retail access lines served residential consumers and 50% served business customers.

Wireless. We provide statewide mobile and fixed voice and data communications services to approximately 134,000 wireless subscribers throughout Alaska. Our wireless networks have a covered population of approximately 542,000, representing approximately 81% of the state s population, according to the 2006 U.S. Census Bureau estimates. We serve approximately 24.7% of our covered population. In 2005 and 2006, we aggressively expanded our CDMA 1xRTT and EV-DO network, which features advanced mobile data services. We expect to substantially complete our expansion of this network in 2007. We also provide wireless services using our time division multiple access (TDMA) digital network which we maintain for subscribers who have not yet upgraded to CDMA.

Internet. We provide Internet access services to approximately 57,000 subscribers, including high-speed digital subscriber line (DSL) service to approximately 44,000 subscribers. Our DSL service is currently available to approximately 75% of our local telephone access lines. As part of our Internet services, we also provide advanced IP-based private networks to large enterprise and governmental customers in Alaska.

Interexchange. We offer long distance and interexchange private-line services primarily as a facilities-based carrier to approximately 64,000 long distance customers.

Video. We offer customers in Alaska satellite video entertainment through our partnership with the DISH network.

For the fiscal year ended December 31, 2006, 54.9%, 33.0%, 7.2% and 4.9% of our revenues came from local telephone, wireless, Internet, and interexchange services, respectively. For more detailed information, please see Products, Services and Revenue Sources below.

Competitive Strengths and Business Strategy

We seek to maintain and grow our cash flow and investor returns as the premier telecommunications services provider in Alaska. While the communications marketplace converges and competition continues to enter the market, we plan to achieve our goals through the following principal strategies:

Use our existing strong competitive position to grow our retail relationships. We believe we already have the leading competitive position in Alaska.

- We are the incumbent local telephone company in all of Alaska s major population centers and more than 70 other communities;
- We are the only provider of mobile broadband wireless service, and the second largest wireless communications services provider; and
- We are the largest provider of DSL services and the second largest provider of Internet access services.

We build upon this leading competitive position with an eye to the future of communications, and we seek to offer the most advanced products and services to our large customer base.

Develop and offer new products targeted at the highest-growth markets. We currently offer products in two of the highest-growth telecommunications markets: wireless and Internet. In each of these markets, we own and operate our networks. We believe our facilities-based strategy places us in an advantageous position relative to our competitors who do not offer similar facilities-based services in each of these high-growth markets. Our primary competitor, General Communication, Inc. (GCI) offers facilities-based cable Internet services that compete directly with our high-speed DSL services. Further, GCI has begun deploying cable telephony, through which it provides facilities-based local telephone service. However, GCI primarily resells wireless services through a partnership with Dobson Cellular Systems, Inc. (Dobson), our main wireless competitor. Dobson operates only wireless facilities. Thus, among our primary competitors, we believe we offer the optimal mix of products designed to help us benefit from high-growth areas in the industry. We expect to continue developing new products in these high-growth areas to enhance our competitive position.

Maintain advanced networks and facilities. We have designed our wireless and wireline networks to accommodate developing products and technology. We operate a Multi-Protocol Label Switching over Asynchronous Transfer Mode (MPLS/ATM) network. Because our advanced MPLS/ATM network uses standard protocols, we can offer our customers a complete suite of integrated telecommunications services, while achieving significant operating efficiencies. The enhanced products that converge over our MPLS core network include the following:

virtual private networks and lines;

voice over Internet Protocol services;

transparent local area networks (LANs) and proprietary LANs and wide area networks (WAN);

high speed Internet access;

managed services; and

video conferencing.

In addition, we provide the only statewide mobile broadband wireless service, and we are the second largest provider of Internet access service in Alaska. We aim to provide wireless service primarily through our state-of-the-art CDMA 1xRTT and EV-DO wireless network. This state-of-the-art network currently serves 95% of our wireless subscribers, and we anticipate 100% of our subscribers will be served by our CDMA network by year-end 2007. In addition to our CDMA network, we maintain a secondary TDMA digital network for our non-CDMA subscribers. Our growing CDMA network has allowed us to expand our wireless network coverage and to offer a wider range of wireless and mobile broadband data services. We believe our expanded wireless services, compared to our competitors, will allow us to capture new retail relationships and win back wireline subscribers with integrated offerings.

Offer integrated, customer-focused services. We believe we offer the leading portfolio of integrated communications services to Alaskans, including local telephone, wireless, Internet, long distance, messaging, video entertainment, and other services. We believe that offering our customers bundled packages results in customer subscription to a greater number of our products and services and is a key component of our success. Bundling allows our customers a one stop shopping experience, fewer billing statements, and greater value for price across a number of services. In 2005, we began our ON ACS program, through which we offer discounts to customers subscribing to both our local telephone and wireless services at prescribed service levels. Our ON ACS program, as well as our bundled offerings, allows us to use our advanced CDMA 1xRTT and EV-DO wireless network and our high-speed DSL service to gain long distance and local telephone subscribers.

Recruit and maintain a strong, experienced management team. We have a highly experienced senior management team with an average of approximately 13 years of experience in the local telecommunications industry and a proven track record of operating and managing integrated telecommunications companies. Our executive management team has broad experience in the telecommunications industry and understands the dynamics of the

Alaskan markets and our customers. Liane Pelletier joined us in October 2003 as CEO and President and became Chairperson of our board of directors on January 1, 2004. Before joining us, Liane worked for 17 years at Sprint Corporation, most recently as a member of the Executive Management Committee and as Chief Integration Officer. David Wilson, who was previously Chief Financial Officer of Triumph Communications and DIRECTV Broadband, joined us as our Chief Financial Officer in March 2004. In addition, in 2003, David C. Eisenberg joined us from Sprint as Senior Vice President, Corporate Strategy, Development and Marketing and in February 2004, Sheldon Fisher joined us from Sprint as Senior Vice President, Sales and Service. Most recently, in August 2006, Anand Vadapalli, joined us as Senior Vice President, Network and IT Operations. Prior to joining us, Anand served as the Vice President, Information Technology at Valor Telecom.

Review and improve internal processes to increase efficiency. We formed and continue to maintain Process Improvement Teams . The goal of these teams is to remedy known inefficiencies in various areas of our company. To date, the teams have improved our customer service by reducing set up times for DSL, shortening wait time for customer calls allowing more time for problem resolution and sales, and designing clearer billing statements, which resulted in fewer customer complaints and inquiries. Our teams have also increased the accuracy of forecasting for service procurement, reduced time required to provision circuits, and designed a company-wide product development process through which all new products undergo rigorous analysis, troubleshooting, and testing before they enter the market.

Products, Services and Revenue Sources

We generate revenue from the provision of local telephone, wireless, Internet, and interexchange services. The following table sets forth the components of our consolidated revenues for the years ended December 31, 2006, 2005, and 2004:

	Revenue for the Year Ended December 31, (in millions)					
	2006		**2005**		**2004**	
	Amount	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
Revenue by Source:						
Local network service	$ 80.2	22.9%	$ 86.5	26.5%	$ 91.7	30.3%
Network access	90.9	26.0	92.4	28.3	97.5	32.2
Deregulated and other revenue	21.0	6.0	23.9	7.3	22.0	7.3
Local telephone	192.1	54.9	202.8	62.0	211.2	69.8
Wireless	115.6	33.0	86.2	26.4	56.7	18.7
Internet	25.2	7.2	21.7	6.6	20.2	6.7
Interexchange	16.9	4.9	16.1	4.9	14.6	4.8
Total	$ 349.8	100.0%	$ 326.8	100.0%	$ 302.7	100.0%

Local telephone

We are the largest local exchange carrier in Alaska. We provide local telephone service through our four local telephone companies. Our local telephone revenue consists of local network service, network access (including universal service revenue), and deregulated and other revenue, each of which we describe below.

Local network service

Our local network services consist of basic local network service and competitive local network service.

Basic local network service. Basic local network service enables customers to make and receive telephone calls within a defined exchange area. We provide basic retail local services to consumer and business customers, generally for a fixed monthly charge. The amount that can be charged to a customer for basic local services is determined by rate proceedings governed by the Regulatory Commission of Alaska (RCA). We generally charge business customers higher rates to recover a portion of the costs of providing local service to consumers, as is customary in the industry. Our basic local service also includes non-recurring charges to customers for installation and recurring charges for enhanced features such as call waiting, caller identification, and call forwarding.

Competitive local network service. We provide interconnection to our basic local service and lease unbundled network elements (UNEs) to our competitors. We report revenues for these services as local network service revenues. As of November 26, 2004, the RCA authorized us to increase the Unbundled Network Element loop (UNE-L) rate for our Anchorage service area to $18.64 retroactively to June 2004. In the Fairbanks and Juneau service areas, the RCA authorized us to increase UNE loop rates to $23.00 and $18.00, respectively, as of January 1, 2005. We provided approximately 57,800 lines to competitors in the Anchorage, Fairbanks and Juneau service areas on either a wholesale or UNE basis as of December 31, 2006. Beginning on December 28, 2006, the Federal Communications Commission

(FCC) authorized us to increase our UNE loop rates on new UNE s in substantially all of the Anchorage service area to $23.00. Effective January 1, 2008, all UNE loop rates will increase to $23.00.

The table below sets forth the number of access lines as of December 31, 2006, 2005 and 2004. The number of access lines shown represents all revenue producing access lines connected to both retail and wholesale customers.

	As of December 31,		
	2006	2005	2004
Retail access lines	194,815	199,341	206,209
Wholesale access lines	11,226	13,966	16,590
Unbundled network elements	46,626	57,578	70,954
Total local telephone access lines	252,667	270,885	293,753

Network access

We charge interexchange carriers for network access services for originating and terminating long distance or toll calls on our network. We also receive universal service revenue, which we report as network access revenue. We describe these components of network access revenue below.

Intrastate access charges. We generate intrastate access revenue when an intrastate long distance call carried by an interexchange carrier originates and/or terminates on one of our local telephone networks. We also provide billing and collection services for interexchange carriers through negotiated agreements for certain types of toll calls placed by our local customers. Our subsidiaries, ACS of Anchorage, Inc. (ACSA), ACS of Alaska, Inc. (ACSAK) and ACS of Fairbanks, Inc. (ACSF) operate under their own tariffs for intrastate access. In non-competitive areas, our subsidiary, ACS of the Northland, Inc. (ACSN) participates in a mandatory statewide tariff and access charge pooling arrangement that is administered by the Alaska Exchange Carriers Association (AECA). The RCA regulates access charges for our intrastate services.

Interstate access charges. We generate interstate access revenue when a long distance call involving another state originates and/or terminates on one of our local telephone networks. The FCC regulates interstate access charges. All our local telephone companies, except ACSA, participate in a nationwide tariff and access charge pooling arrangement administered by the National Exchange Carrier Association (NECA). ACSA participates in the NECA common line tariff, but has its own interstate access tariff for traffic sensitive and special access services. We also categorize as interstate access revenue common line revenues billed to the end user for the FCC-mandated interstate charges.

Universal service revenue. We currently receive federal universal service revenue in some of our local telephone service areas. Universal service revenue supplements the amount of local service revenue we receive to ensure that basic local service rates for customers in high cost rural areas are not significantly higher than rates charged in lower cost urban and suburban areas.

Deregulated and other revenue

Deregulated and other revenues consist of billing and collection contracts, space and power rents, pay telephone service, deregulated customer premise equipment sales (CPE), regulated directory listing revenue, and other miscellaneous telephone revenue. We seek to capitalize on our local presence and network infrastructure by offering these additional services to customers and interexchange carriers.

Wireless

We provide statewide mobile voice and data communications services throughout Alaska. We are the only statewide provider to offer CDMA and EV-DO. We believe CDMA provides better capacity for voice and data communications than other commercial mobile technologies because it allows more subscribers to connect at any given time. Our CDMA network provides our customers with improved voice call quality, security, average mobile data speeds of 60-80kbps over 1xRTT and multiples of this over EV-DO, and other enhanced services, such as wireless email, web, digital picture taking/sending, assisted-GPS position location applications, video and audio streaming.

Table of Contents

We estimate our wireless network footprint covers approximately 542,000 or 81%, of Alaska s approximately 670,000 residents, including all major population centers and highway and ferry corridors. Our EV-DO mobile wireless broadband service, enables high speed data connectivity with speeds that burst up to 2mbps in Anchorage, Fairbanks, Juneau, and a few other popular areas throughout Alaska. While using our EV-DO network, our customers do not need to locate a WiFi Hot Spot to obtain wireless broadband service. We also operate a TDMA digital network in substantially all of our service areas for our customers who have not yet upgraded to CDMA.

Our wireless segment generates revenue through subscriber access charges, airtime usage, toll charges, connection fees, roaming revenues, and enhanced features, such as short messaging services. A subscriber may purchase services separately or may purchase rate plans that package these services in different ways to fit different calling patterns and desired features.

We have eligible telecommunications carrier (ETC) status in a significant portion of our rural wireless service area. By obtaining ETC status, we become eligible to receive universal service funded support for wireless subscribers residing in the areas covered by this designation.

Subscribers. The table below sets forth the annual growth in the number of our wireless subscribers served and our total covered population as of December 31, 2006, 2005 and 2004.

	As of December 31,		
	2006	**2005**	**2004**
Estimated covered population	541,940	523,827	482,251
Ending subscribers	133,988	117,537	100,657
Ending penetration	24.7%	22.4%	20.9%

We believe there are opportunities to improve coverage and subscription rates of our wireless operations throughout Alaska. We also believe that the market for wireless services will continue to grow.

Licenses. We own 800 megahertz B side cellular licenses which cover the major population centers in Alaska, including Anchorage, Fairbanks, Juneau, and the Kenai Peninsula. We also own several 10 megahertz E Block PCS licenses covering the entire state including Anchorage, Fairbanks and Juneau and 10 megahertz F Block PCS licenses covering Fairbanks and Juneau.

Internet

We offer high-speed DSL service over our access lines in our major local telephone service territories. Approximately 75% of our access lines in these major local telephone service territories have the capability to provide DSL service. We also offer dial-up Internet service. We charge customers either a flat rate for unlimited use or a measured rate based on usage.

Interexchange

We currently serve approximately 64,000 long distance customers who have selected us as their preferred interexchange carrier. We believe our interexchange revenue represents less than 5% of total interexchange revenues in Alaska. We own fiber capacity for high-speed links within Alaska and for transportation of call traffic outside Alaska. We also resell the services of other long distance carriers.

Video entertainment

We partner with the DISH Network, a leading satellite television provider, to offer our customers video entertainment. Our agreement with DISH Network will terminate in December 2007 if it is not extended.

Table of Contents

Seasonality

We believe our 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. Our other business segments experience similar seasonal effects, but we do not believe these effects are material.

Sales and Marketing

We market our products and services under the Alaska Communications Systems and ACS brands, subject to regulatory and strategic business considerations. Key components of our sales and marketing strategy include:

- establishing name recognition of the ACS brand across all product and service offerings;
- making, buying and using ACS products and services easier than ever;
- marketing all of our offerings to each consumer to obtain a greater percentage of each consumer s telecommunications services expenditures;
- providing convenient and valuable bundles of products and services;
- centralizing marketing functions to optimize impact and efficiency;
- improving quality and reliability of customer service;
- developing and delivering to the market new products and services driven by a view of total customer needs;
- driving greater productivity from direct sales efforts; and
- teaming sales and service for a complete and seamless customer experience.

We use our position as an integrated, one-stop provider of telecommunications services with strong positions in local telephone, wireless, Internet and interexchange markets. By pursuing a marketing strategy that facilitates integration, cross-selling, and packaging of our products and services, we believe we can increase penetration of new product offerings, improve customer retention rates, increase our share of our customers overall telecommunications expenditures, and achieve continued revenue and operating cash flow growth.

Network and Technology

As of December 31, 2006, we owned host switches serving approximately 253,000 access lines. All of our access lines are served by digital switches provided predominantly by Nortel Networks Corporation. Our switches are linked through a combination of extensive aerial, underground and buried cable, including fiber-optic cable and digital microwave and satellite links. We have 100% single-party services, or services of one customer per access line, and believe substantially all of our major switches have current generic software upgrades installed which allows for the full range of enhanced customer features, such as call waiting, caller identification, and call forwarding.

We have integrated numerous network elements to offer a variety of services and applications that meet the increasingly sophisticated needs of our customers. These elements include Signal System 7 signaling networks, voice messaging platforms, digital switching, DSL and, in some communities, integrated service digital network access. As the telecommunications industry experiences significant changes in technology, customer demand and competition, we intend to introduce additional enhancements.

Technicians located at our network operating control center in Anchorage operate and monitor our wireline and wireless networks seven days a week, 24 hours a day. Our customer care call center and walk-in facilities in Anchorage and Fairbanks and additional walk-in customer care facilities in Juneau, Sitka, Kenai/Soldotna, Kodiak, North Pole and Homer sell and service all of our product lines. All of these facilities offer extended business hours to efficiently handle customer inquiries and orders for service.

Our wireless operations consist of five digital switching centers, approximately 194 cell locations, which in certain cases include multiple base stations, and three repeaters covering 80.9% of Alaska s population and substantially all major population centers and highway corridors in the state plus one analog switch and cell site covering Barrow, Alaska. We link our switching and cell site infrastructure primarily by our proprietary fiber, wireline and digital microwave connections. We have constructed and are continuing to enhance and expand our commercial wireless voice and data CDMA 1xRTT and EV-DO networks. Our CDMA network consists of two Nortel digital CDMA switches and 172 cell sites as of December 2006. We also operate a

Table of Contents

TDMA network for our customers who have not yet upgraded to CDMA. Our TDMA wireless voice network consists of three Ericsson digital switches, one analog switch serving Barrow, Alaska, and approximately 105 base stations using our 800 megahertz B side cellular licenses. Our TDMA network covers the major population centers in Alaska, including Anchorage, Fairbanks, Juneau and the Kenai Peninsula. We plan to continue to expand our CDMA 1xRTT and EV-DO networks and migrate our TDMA subscribers onto our CDMA network. Our CDMA network was initially deployed using our 10 megahertz E and F Block PCS spectrum, but we expect to eventually deploy CDMA technology over our 800 megahertz B side cellular licenses and phase out TDMA service in the future.

Our facilities-based long distance network connects the major population center of Anchorage, Fairbanks, Juneau and the Kenai Peninsula to each other primarily over owned fiber-optic facilities or Indefeasible Rights of Use (IRU) capacity. We own IRU fiber-optic capacity connecting Alaska to the rest of the world via Seattle, Washington.

Competition

Local telephone service

Our local telephone services operations may be subject to any of several types of competition:

- facilities-based competition from providers with their own local service network;
- resale competition from resale interconnection, or providers who purchase local service from us at wholesale rates and resell these services to their customers;
- competition from UNE interconnection, that is, providers who lease UNEs from us; and
- alternatives to local service networks, including wireless, IP, satellite and cable telephony.

In September 1997, GCI and AT&T Alascom, the two largest long distance carriers in Alaska, began providing competitive local telephone services in Anchorage. GCI competes principally through UNE interconnection using the facilities of our local telephone subsidiary, ACSA, and increasingly over its own facilities. AT&T Alascom competes primarily by reselling ACSA s services. Competition is based upon price and pricing plans, types of services offered, customer service, billing services, and quality and reliability of service. GCI has focused principally on advertising discount plans for bundled services. AT&T Alascom s strategy has been to resell ACSA s service as part of a package of local and long distance services. As a result, in Anchorage, ACSA had only approximately 48% competitive market share as of December 31, 2006. We expect GCI and AT&T Alascom to continue to compete with us for local telephone business in many of our markets.

As of December 31, 2006, we estimate that we had approximately 68% market share in Fairbanks. GCI has competed in Fairbanks primarily through reselling services and through UNE interconnection. Similar trends are being experienced by ACSAK in our Juneau market where, as of December 31, 2006, we had approximately 60% market share.

We expect increasing competition from providers of various services that bypass our network. Long distance companies may construct, modify, or lease facilities to transmit traffic directly from a user to a long distance company. Cable television companies may modify their networks to partially or completely bypass our local network. GCI commenced deployment of cable telephony in 2004 and continues to migrate its customers served using our UNEs off of our network and onto its own cable system. This migration of our network will result in a significant reduction of revenue for us, as GCI would no longer be leasing our facilities to serve those customers.

In addition, while wireless telephone services have historically complemented traditional local exchange carrier (LEC) services, we anticipate that existing and emerging wireless technologies may increasingly compete with LEC services. For example, we have deployed CDMA 1xRTT and EV-DO wireless services in certain of our markets. Our principal wireless competitor, Dobson, is deploying GSM wireless services. Both CDMA and GSM technologies may serve as a satisfactory wireless alternative to traditional LEC wireline services. At this time we cannot predict the impact of the growth in wireless networks on our share of the local market. Technological developments in wireless telephone features, digital microwave, and other wireless technologies are expected to further permit the development of alternatives to traditional wireline services. Further, the FCC s requirement that incumbent local exchange carriers (ILECs), such as us, offer wireline-to-wireless number portability may also increase the competition ILEC companies face from wireless carriers.

Wireless services

The wireless telecommunications industry has experienced rapid technological change, an increasing pace of improvements in the capacity and quality of digital technology, shorter cycles for new products and enhancements, and changes in consumer preferences and expectations. We believe that demand for wireless telecommunications services will likely increase as equipment costs and service rates continue to decline and equipment becomes more convenient and functional. Wireless providers compete over price, quality, network coverage, packaging features, and brand reputation. There are six PCS licensees in each of our wireless service areas. We hold B side cellular licenses for Alaska s major communities and PCS licenses covering the entire state, including Anchorage, Fairbanks, Juneau, and the Kenai Peninsula. We currently compete with at least one other facilities-based wireless provider in each of our wireless service areas, including Dobson and Alaska DigiTel, LLC (Alaska DigiTel). We also face competition from GCI, which is a branded reseller of Dobson. In addition, Dobson, our main wireless competitor, also provides some coverage on its own network in multiple states outside Alaska. We believe that the unique and vast terrain and the high cost of a PCS system build-out, however, make additional competitive entry into markets outside of Anchorage difficult.

Competition, for simpler wireless voice service has forced carriers such as us to reduce prices. We seek to offset this impact by bringing new higher-margin services to market, developing products for targeted market segments, and using our advantage in market share and geographical coverage to attract new customers and offer new services to existing customers. We continuously evaluate new services in order to differentiate us from our competitors, produce additional revenues, and increase margins.

Internet services

We offer DSL services in Anchorage, Fairbanks, Juneau, Kenai/Soldotna, Homer, Kodiak, and Sitka, Alaska for both consumers and businesses. The market for Internet access services is highly competitive in most markets in the state. Few significant barriers restrict entry into the market, and we expect that competition will intensify in the future. We primarily compete with GCI in the market for Internet access services.

In addition to GCI, we currently compete with a number of established online services companies, interexchange carriers, and cable television operators. Competition is particularly intense for broadband services. The number of cable modems deployed by GCI is approximately two times the number of DSL modems deployed by us. Further, the addition of wireless broadband to the mix of options available to consumers may reduce the demand for DSL. We believe that our ability to compete successfully will depend upon a number of factors, including the reliability and security of our network infrastructure, the ease of access to the Internet, particularly broadband access, and our competitors prices.

Interexchange services

The long distance telecommunications market is highly competitive. We believe we currently have less than 5% of total interexchange revenues in Alaska. Competition in the long distance market is primarily on price, although service bundling, branding, customer service, billing services, and quality also play a role in customers choices. We currently offer long distance service to customers located primarily in the more populated communities within our service territory. AT&T Alascom and GCI are currently the two major competing long distance providers in Alaska. We also face competition from wireless service providers for long distance customers. In addition, new carriers offering voice over Internet protocol services may lead to a reduction in traditional long distance telephone service customers. Further, we also compete with prepaid calling cards that reduce traditional reliance on long distance telephone service and also deprive us of revenue obtained from the use of our interexchange facilities. We provide traditional 1+ direct long distance dialing, toll-free services, calling cards, and private line services for data and voice applications. We have also introduced flat-fee long distance programs. These programs allow customers to purchase interstate minutes of use in blocks of time for a single monthly fee. We expect to continue offering products of this nature in the future.

Video entertainment

We resell the DISH Network in Alaska. DISH Network s primary competitor is GCI, the cable provider in most of Alaska. GCI holds a dominant position in the video entertainment sector. Our current agreement with DISH Network became effective August 2003 and either will be renegotiated or will terminate in December 2007.

Employees

As of January 31, 2007, we employed approximately 986 regular full-time employees, 7 regular part time employees and 8 full time temporary employees. 78.3% of our employees 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. On November 2, 1999, the IBEW membership for our company ratified the terms of a Master Collective Bargaining Agreement that governs the terms and conditions of employment for all IBEW represented employees working for us in the State of Alaska. The November 1999 agreement, which was due to expire on December 31, 2006, provided for wage increases up to 4% in specified years based on the annual increases in the consumer price index for Anchorage as reported by the U.S. Department of Labor CPI-U. The agreement limits the increases in our health and welfare contributions for represented employees to 4% annually. On February 23, 2005, the membership of the IBEW ratified an extension to the collective bargaining agreement through 2009 and accepted certain modifications to the agreement.

Non-represented employees qualify for wage increases based on individual and company performance, and key employees are also eligible for performance-based incentives. We provide a total benefits package, including health, welfare, and retirement components that we believe is competitive in our market.

Website Access to Reports

Our investor relations website Internet address is www.alsk.com. The information on our website is not incorporated by reference in this annual report on Form 10-K. We make available, free of charge, on our investor relations website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. These reports are available as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

Regulation

The following summary of the regulatory environment in which our business operates does not describe all present and proposed federal, state and local legislation and regulations affecting the telecommunications industry in Alaska. Some legislation and regulations are currently the subject of judicial review, legislative hearings and administrative proposals which could change the manner in which this industry operates. We cannot predict the outcome of any of these matters or their potential impact on our business. Regulation in the telecommunications industry is subject to rapid change, and any such change may have an adverse effect on us.

Overview

The telecommunications services we provide and from which we derive a large majority of our revenue are subject to extensive federal, state and local regulation. Our LEC subsidiaries are regulated common carriers and have the right to set maximum rates at a level that allows us to recover the reasonable costs incurred in the provision of regulated telecommunications services and to earn a reasonable rate of return on the investment required to provide these services. Because they face competition, however, most of our LEC subsidiaries may not be able to realize their allowed rates of return.

In establishing rates for regulated services, our LEC subsidiaries first determine their aggregate costs and then allocate those costs between regulated and non-regulated services, then separate the regulated costs between the state and federal jurisdictions, and finally among their various interstate and intrastate services. This process is governed primarily by the FCC s rules and regulations. The FCC is considering whether to modify or eliminate the current jurisdictional separations process. This decision could indirectly increase or reduce earnings of carriers subject to jurisdictional separations rules by affecting the way regulated costs are divided between the federal and state jurisdictions, if rates in both jurisdictions are not adjusted accordingly. Maximum rates for regulated services are regulated by the FCC for interstate services and by the RCA for intrastate services.

At the federal level, the FCC generally exercises jurisdiction over services of telecommunications common carriers, such as us, that provide, originate or terminate interstate or international communications and related facilities. The FCC does not directly regulate enhanced services and has preempted inconsistent state regulation of enhanced services. Our wireless services use FCC radio-frequency licenses and are subject to various FCC regulations, including enhanced 911(E911) and number portability requirements. The RCA generally exercises jurisdiction over services and facilities used to provide, originate or terminate communications between points in Alaska. In addition, pursuant to the federal Telecommunications Act of 1996 (Telecommunications Act) federal and state regulators share responsibility for implementing and enforcing policies intended to

13

foster competition in local telecommunications services. In particular, state regulatory agencies have substantial oversight over the provision by ILECs of interconnection and non-discriminatory network access to competitive local exchange carriers (CLECs). Local governments often regulate the public rights-of-way necessary to install and operate networks. These local governments may require communications services providers to obtain licenses or franchises regulating their use of public rights-of-way, and may require carriers to obtain construction permits and abide by building and land use codes.

Federal regulation

We must comply with the Communications Act of 1934, as amended (Communications Act) and regulations promulgated there under which require, among other things, that communications carriers offer interstate services at just, reasonable and nondiscriminatory rates and terms. The amendments to the Communications Act contained in the Telecommunications Act significantly changed and are expected to continue to change the regulation of the telecommunications industry. The Telecommunications Act promotes competition in local telecommunications services by removing barriers to entry, imposing interconnection and network access requirements, and making universal service support explicit and portable. We must obtain FCC approval before we transfer control of any of our common carrier subsidiaries or our radio frequency licenses or authorizations, make such an acquisition, or discontinue an interstate service.

Interconnection with local telephone companies and access to other facilities

In order to ensure access to local facilities and services at reasonable rates the Communications Act imposes a number of access and interconnection requirements on LECs. Generally, a LEC must: not prohibit or unreasonably restrict the resale of its services; provide for telephone number portability, so customers may keep the same telephone number if they switch service providers; ensure that customers are able to route their calls to telecommunications service providers without having to dial additional digits; provide access to their poles, ducts, conduits and rights-of-way on a reasonable, non-discriminatory basis; and, when a call originates on its network, compensate other telephone companies for terminating or transporting the call.

Most ILECs have the following additional obligations under the Communications Act: negotiate in good faith with any carrier requesting interconnection; provide interconnection for the transmission and routing of telecommunications at any technically feasible point in its network on just, reasonable and non-discriminatory rates, terms and conditions; provide access to UNEs, such as local loops, switches and trunks, or combinations of UNEs at nondiscriminatory, cost-based rates; offer retail local telephone services to resellers at discounted wholesale rates; provide notice of changes in information needed for another carrier to transmit and route services using its facilities; and provide physical collocation, which allows a CLEC to install and maintain its network termination equipment in an ILEC s central office, or to obtain functionally equivalent forms of interconnection.

Our ACSN ILEC subsidiary enjoys a statutory exemption as a rural carrier from the interconnection requirements imposed on most ILECs. The RCA may terminate the exemption, if it determines the interconnection is technically feasible, not unduly economically burdensome and consistent with universal service. The Telecommunications Act does not, however, preclude facilities-based competition, and the RCA has granted GCI, subject to certain conditions, approval to provide local exchange telephone service in the Glacier State and Sitka study areas of ACSN. New facilities-based local exchange service competition may reduce our revenues and returns.

On April 18, 2004, ACSF and ACSAK entered into a settlement agreement with GCI in which ACSF and ACSAK waived their claim to the rural exemption in exchange for GCI s agreement to pay increased UNE loop rates.

To implement the interconnection requirements of the Telecommunications Act, the FCC adopted rules requiring, among other provisions, that ILECs price UNEs based on forward-looking economic costs using the total element long-run incremental cost methodology. In February 2005 the FCC released an order eliminating the obligation of ILECs to provide access to switching as a UNE, as well as the obligation to provide the combination of UNEs known as the UNE platform (UNE-P). These changes did not affect the obligations of ACSF or ACSAK under their agreement with GCI, which remains in effect until January 1, 2008. Currently, the FCC is reexamining its pricing standard for UNEs and may reconsider other aspects of its rules.

In September 2005, ACSA filed a petition seeking FCC forbearance from our requirement to lease UNEs to our competitors in Anchorage at regulated rates. Also in September 2005, the FCC established precedent for granting relief similar to that sought by ACSA by granting forbearance relief to Qwest in its Omaha market due to substantial inter-modal competition in that market. On December 28, 2006, the FCC conditionally and partially granted ACSA forbearance from the obligation to lease UNEs to our competitors at regulated rates. This forbearance was limited to five wire centers within the Anchorage service area of ACSA. Even where relief was granted, however, the FCC has required ACS to lease loops and sub-loops at commercially negotiated rates, or if there is no commercial agreement, at the rates for these UNEs in Fairbanks. A one-year transition period was part of the FCC s Order. On February 9, 2007, ACSA and GCI independently filed appeals of the FCC s Order.

Congress may consider legislation that may further modify the Communications Act and the FCC and the RCA frequently considers modifications of their rules. We cannot predict the outcome of any such of any action taken by the Congress, the FCC or the RCA.

Interstate access charges

The FCC regulates the prices that ILECs charge for the use of their local telephone facilities in originating or terminating interstate transmissions. Our ILECs interstate access charges are developed using a cost-of-service methodology, based on our authorized maximum rate of return. NECA develops averaged access rates for participating ILECs, including our ILECs, based on the costs of these carriers. All our ILECs participate in NECA s tariff for non-traffic sensitive costs, which are primarily loop costs. While ACSA files its own traffic sensitive access tariff, which covers primarily switching costs, our other ILECs participate in NECA s traffic sensitive access tariff. Participants in a NECA tariff charge averaged access rates, pool their revenues, and distribute the revenues on the basis of each individual carrier s costs. The NECA tariffs reduce the cost burden on individual ILECs of filing tariffs and also spread some of the risks of providing interstate access services. None of our ILECs has chosen the FCC s price cap method for its interstate access charges.

In 2001, the FCC adopted an order implementing certain proposals of the Multi-Association Group (MAG) to reform the access charge system for rural ILECs. Among other things, the MAG plan reduces usage sensitive access charges on long distance carriers and shifts a portion of cost recovery to subscriber line charges, which are paid by end users, and new explicit universal service support. The FCC also implemented a freeze on jurisdictional cost separations factors that expired in June of 2006, but the separations factor freeze was extended indefinitely in May of 2006. The FCC is currently considering various proposals for further reform. These proposals may result in the elimination of interstate and intrastate access charges paid by long distance carriers, and the requirement that carriers such as ACSA, ACSF, ACSAK and ACSN recover those interstate and intrastate costs from a combination of end-user charges and universal service support. Various groups of carriers and regulators are developing new proposals for replacements to the MAG plan to submit to the FCC. We cannot predict what changes the FCC may adopt or when they may adopt them.

Federal Universal Service Support

The Communications Act requires the FCC to establish a universal service program to ensure that affordable, quality telecommunications services are available to all Americans. The program at the federal level has several components, including one that pays support to LECs serving areas for which the costs of providing basic telephone service are higher than the national average. The Telecommunications Act requires the FCC to make universal service support explicit, expand the types of communications carriers that are required to pay universal support, and allow competitive providers including CLECs and wireless carriers to be eligible for universal service support, including where they serve customers formerly served by ILECs.

In May 2001, the FCC adopted a proposal from the Rural Task Force to reform universal service support for rural areas. As adopted, for an interim period, eligible rural carriers will continue to receive support based on a modified embedded cost mechanism. While the modified embedded cost mechanism remains in place in 2007, the FCC has indicated that, it will develop a comprehensive plan for high-cost support mechanisms for rural and non-rural carriers which may rely on forward-looking costs. In June, 2004, the Federal-State Joint Board sought comment on certain reforms, such as the proper definition to use in determining whether a carrier should be supported under the rural mechanism (as opposed to the non-rural mechanism based on forward-looking costs), the basis on which support levels for rural carriers (both ILECs and CLECs) should be calculated. These issues remain pending before the Joint Board, which has not offered a definitive proposal to reform universal service support. If it does so, the FCC would have one year to act on these recommendations. In addition, members of Congress have indicated that they may seek enactment of legislation addressing universal service reform, including legislation to limit growth of explicit universal service support funds. We are unable to predict whether and to what extent we would be eligible to receive any federal high-cost support under such a plan.

15

Table of Contents

Universal service funds are only available to carriers that are designated as ETCs, by a state regulatory commission for carriers subject to state jurisdiction, or by the FCC, for other carriers not subject to state jurisdiction. On March 17, 2005, the FCC adopted new and more stringent guidelines concerning the designation of competitive carriers as ETCs (CETCs) for designations that it makes under its jurisdiction. Although the new guidelines are not binding on state commissions, several parties have asked the FCC to require states to follow them on reconsideration. The RCA has commenced a state rulemaking proceeding to consider possible changes prompted by the FCC guidelines. We do not anticipate any impact on the eligibility of our ILECs to receive universal service support as a result of these rule changes.

Under current FCC regulations, the total amount of federal universal service funds available to all ILEC ETCs is subject to a yearly cap. In any year where the cap is reached, the per access line rate at which ILECs can recover Universal Service Fund payments may decrease. In each of the last few years, the cap has effectively decreased Universal Service Fund (USF) payments.

We also expect the FCC to act in 2007 to reform the current funding mechanism for the universal service support funds. Today, our operating subsidiary companies are required to contribute to the federal USF a percentage of their revenue earned from interstate and international services. The FCC is currently considering whether to replace this funding mechanism with one based on flat-rated, per-line contributions, capacity-based contributions, or some combination of these or other proposals. We cannot predict how the outcome of this proceeding may affect our contribution obligations.

Interstate long distance services

FCC regulation of the rates, terms or facilities of our interstate long distance services is relatively light. However, we must comply with the general requirement that our charges and terms be just, reasonable and non-discriminatory. Also, we must comply with FCC rules regarding unauthorized switching of a customer s long distance service provider, or slamming; the FCC has levied substantial fines on some carriers for slamming. In addition, ACSLD must post the rates, terms and conditions of its service on its Internet web site and engage in other public disclosure activities.

The FCC required that ILECs that provide interstate long distance services originating from their local exchange service territories must have long distance affiliates which maintain separate books of account and acquire any services from their affiliated ILECs at tariff rates, terms and conditions.

On December 8, 2004, Congress enacted a new law requiring, through 2009, the purchase and sale of interstate wholesale switched service elements at rates equivalent to the rates set forth in AT&T Alascom s Tariff 11, subject to annual downward adjustments specified in the statute. Rural telephone companies, or companies that are affiliated with and under the control of rural telephone companies, are exempt from the requirement to purchase services at such rates.

Wireless services

The FCC regulates the licensing, construction, operation, acquisition and sale of personal communications services and cellular systems in the United States. All cellular and personal communications services licenses have a 10-year term, at the end of which they must be renewed. Licenses may be revoked for cause, and license renewal applications may be denied if the FCC determines that renewal would not serve the public interest. In addition, all personal communications services licensees must satisfy certain coverage requirements. Licensees that fail to meet the coverage requirements may be subject to forfeiture of the license.

Federal law preempts state and local regulation of the entry of, or the rates charged by, any provider of commercial mobile radio services (CMRS) which includes personal communications services and cellular services. The FCC does not regulate such rates; however, the FCC imposes a variety of other regulatory requirements on CMRS operators. For example, CMRS operators must be able to transmit 911 calls from any qualified handset without credit check or validation, and are required to provide the location of the 911 caller within an increasingly narrow geographic range. CMRS operators are also required to provide 911 service for individuals with speech and hearing disabilities, or TTY service. The FCC granted ACS a waiver allowing a limited extension of time to comply with the FCC s E911 requirements: (1) that all new handset activations are location-capable; and (2) that 95% of all subscribers have location-capable handsets. Consistent with the FCC s order, all new ACS Wireless, Inc, (ACSW) handset activations have been location-capable since January 1, 2006. Further, ACSW met the FCC s deadline of having 95% of all subscribers using location-capable handsets prior to January 31, 2007.

Table of Contents

FCC regulations also require us to maintain our analog network operations as we transition to our new CDMA wireless network. In December 2006, the FCC granted ACSW a limited waiver of that requirement, allowing ACSW to turn down seven remote and very high cost analog cell sites.

The FCC also requires that if a LEC customer wants to retain a telephone number while changing to a CMRS service provider (such as ACSW), the LEC must have the capability to allow this wireline-to-wireless number portability within six months of a bona fide request, where the requesting CMRS carrier s coverage area overlaps the geographic location of the LEC rate center to which the number is assigned (unless the LEC can provide specific evidence demonstrating that doing so is not technically feasible). These number portability rules are expected to increase the level of competition among CMRS service providers, but also to increase the ability of CMRS providers to win customers from LECs. This rule has had little impact on our LECs, but we cannot predict the net impact of these new rules on us over the long-term.

Internet services

We provide Internet access services as an Internet service provider (ISP). The FCC has classified such services as information services, so they are not subject to various regulatory obligations that are imposed on common carriers, such as paying access charges or contributing to USF. On September 23, 2005, the FCC announced a policy of ensuring neutral access to and operation of the Internet. SBC and Verizon, the two largest ILECs, have agreed to conduct their businesses in compliance with the FCC policy as a condition of the FCC s approval of their acquisitions of AT&T and MCI, respectively. There may be new legislation or further FCC action to address access to the Internet, and we cannot predict the impact of any such actions on our results or operations. Also, the FCC generally preempts state and local regulation of information services.

In October 2005, the FCC determined that ILECs are no longer required to lease high-speed Internet access service transmission capability to their competitors, and re-affirmed its finding that provision of high-speed transmission service bundled with Internet access services is an information service not subject to common carrier regulation, whether that access is provided via cable modem, DSL services, or otherwise. This decision gives us more flexibility in how we offer and price our DSL services. However, for carriers subject to rate-of-return regulation, like the ACS ILECs, the FCC left uncertain whether loop cost allocations would change if they decide to offer the underlying transmission capability on a non-common carrier basis. We currently provide high-speed Internet access transmission capability on a common carrier basis under a stand-alone FCC tariff for ACSA and the NECA tariff for our non-Anchorage LECs. We are considering whether to offer it as non-common carrier service.

In February 2004, the FCC determined that entirely Internet-based voice over Internet Protocol (VoIP) service is an information service and exempt from such regulatory obligations. This finding applied only to VoIP services that do not connect to the public (circuit) switched telephone network. Also in February 2004, the FCC launched a comprehensive rulemaking to determine the appropriate types of regulation, including such matters as intercarrier compensation and contributions to USF, to which ISPs offering or enabling different types of IP services, including VoIP, should be subject. In November 2004, the FCC decided that some VoIP services are exempt from certain state regulations. While VoIP services and high-speed Internet access services generally are not subject to common carrier regulation, the FCC has determined in recent decisions that these services are subject to certain public safety requirements. For example, in May 2005, the FCC found that 911 requirements apply to VoIP. Further, in August 2005, the FCC found that the Communications Assistance for Law Enforcement Act (CALEA) requires providers of both high-speed Internet access services and some VoIP services to ensure that their networks have certain capabilities that facilitate the conduct of electronic surveillance by law enforcement agencies. The FCC has required ISPs including ACSI to be capable of CALEA compliance by May 2007, but we cannot be certain ACSI will meet this deadline. The FCC has also determined that a component of VoIP revenues is subject to USF contributions. Where VoIP providers are unable to specifically identify their interstate traffic, a safe harbor factor is applied.

Other federal regulations

We are subject to various other federal regulations and statutes, including those concerning the use of customer proprietary network information (CPNI) in marketing services, and implementing capabilities to be used by law enforcement officials in executing court authorized electronic surveillance. CPNI generally includes information a carrier has regarding the telecommunications services to which its customer subscribes and the customer s use of those services. In February, 2006, the FCC initiated a rulemaking to determine if it should strengthen its rules governing carrier use and disclosure of CPNI. Other FCC initiatives that may impact our regulated subsidiaries include access to poles, ducts, conduits and rights-of-way, Truth-in-Billing requirements, EEO reporting, hearing aid compatibility requirements, and anti-slamming rules. These requirements may impose costs on us and limit our business opportunities.

State regulation

Telecommunication companies are required to obtain certificates of public convenience and necessity from the RCA prior to operating as a public utility in Alaska. The RCA must approve amendments to and transfers of such certificates. In addition, RCA approval is required if an entity acquires a controlling interest in any of our certificated subsidiaries, if we acquire a controlling interest in another intrastate utility, or if we discontinue an intrastate service. The RCA also regulates rates, terms and conditions for local, intrastate access and intrastate long distance services, supervises the administration of the Alaska Universal Service Fund (AUSF) and decides on ETC status for purposes of the federal USF. Furthermore, pursuant to the Telecommunications Act and the FCC s rules, the RCA decides various aspects of local network interconnection offerings and agreements.

Interconnection

The Telecommunications Act specifies that resale and UNE rates are to be negotiated among the parties subject to approval by the state regulatory commission, or, if the parties fail to reach an agreement, arbitrated by the state regulatory commission. We have entered into interconnection agreements with TelAlaska Long Distance, Inc., Level 3, and numerous other entities, including GCI.

On January 7, 2005, GCI filed suit in federal court seeking reversal of the RCA s 2004 order approving the interconnection agreement between GCI and ACSA. GCI claims that the pricing methodology the RCA used to determine the rates we charge GCI under the interconnection agreement did not comply with the FCC s pricing methodology regulations and requests the court direct the RCA to retroactively reduce the rates we charge GCI under this agreement. ACSA also challenged the RCA s decision, in part, asserting that the RCA unreasonably delayed reaching a final, legal UNE loop rate, that the temporary UNE loop rate set by the RCA did not comply with federal law, and that the RCA s decision regarding the percentage of feeder plant that must be placed in the road prism was not supported by substantial evidence. In November 2006, the court ruled against all claims and upheld the RCA s decision.

Competitive local exchange regulations

In August 2005, the RCA adopted regulations addressing a variety of telecommunications related matters including tariff policies, depreciation practices, local competitive market rules, and interexchange competitive market rules. The regulations provide for, among other things: initial classification of all ILECs, including our rural properties and ACSA, as dominant carriers; requirements that all carriers, both dominant and non-dominant, offer all retail services for resale at wholesale rates consistent with 47 U.S.C. § 251 and 252; and limited dominant carrier pricing flexibility in competitive areas, under which carriers may reduce retail rates, offer new or repackaged services and implement special contracts for retail service upon 30 days notice. Rate increases affecting existing services are subject to full cost support showings by the dominant carrier in areas with local competition; but the RCA may demand, and has demanded, cost support even for rate reductions and new or repackaged services in competitive areas. On September 16, 2005, the RCA defined the ACSA, ACSAK and ACSF service areas as competitive local exchange markets under its new regulations. The RCA had previously granted ACSA, ACSAK and ACSF non-dominant status on a trial basis only for retail tariff purposes. On February 22, 2006, the RCA designated ACSA, ACSAK-Juneau and ACSF as non-dominant carriers in their respective competitive local exchange markets for the provision of retail services except for line extension services, construction services, subdivision agreements and access services. This change in designation has given these three ACS LECs access to relaxed tariff filing rules that allow retail offers to be introduced to the market without advance public notice or RCA approval. We are seeking similar designation changes for ACSN and the second study area in ACSAK to become immediately effective upon receipt of a CLEC s 90-day notice of intent to enter these markets.

End user local rates

The rates charged by our ILECs to end-users for basic local service are generally subject to the RCA s regulation based on a cost-of-service method using an authorized rate of return. Competition may prevent local rates from being sufficient to recover embedded costs for local service. Rate cases are typically infrequent, carrier-initiated and require the

Table of Contents

carrier to meet substantial burdens of proof. The RCA may, however, investigate, upon complaint or upon its own motion, the rates of a LEC and hold hearings on those rates.

Intrastate access rates

ILECs not yet subject to local competition participate in a pool administered by AECA for intrastate access charges to long distance carriers. AECA pools their access costs and sets a statewide average price which participating ILECs charge to long distance carriers for originating or terminating calls. Access revenues are collected in a pool and then redistributed to the ILECs based on their actual costs.

The RCA requires an ILEC to file separate, individual company access charge tariffs when a competitor enters its service area. These tariffs are based on the ILEC s cost of service and are revised biennially. ACSN is our only ILEC associated with AECA. AECA administers ACSN s intrastate access tariff, but ACSN has a stand-alone rate. In 2006, the RCA commenced a state rulemaking proceeding to consider the impact of competition on the access pooling process and whether to continue to require ILECs in competitive markets to exit the AECA pool.

The RCA has adopted regulations limiting the access fees local carriers can charge interexchange carriers and imposing a Network Access Fee on end-users to make up for the reduction in fees paid by interexchange carriers. The RCA is also analyzing the effects of various FCC intercarrier compensation proposals on Alaskan consumers and telecommunications companies.

Alaska Universal Service Fund

The RCA has established the AUSF. The AUSF serves as a complement to the federal USF, but must meet federal statutory criteria concerning consistency with federal rules and regulations. Currently, the AUSF supports a portion of certain higher cost carriers switching costs, the costs of lifeline service (which supports rates of low income customers), and a portion of the cost of Public Interest Pay Telephones. The RCA has adopted regulations that limit high-cost switching support to local companies with access lines of 20,000 or less. This change has eliminated the switching support that our rural ILECs received.

ETC Determinations

The RCA granted GCI s request that it be designated an ETC in Anchorage, Fairbanks, Juneau, and Fort Wainwright, all of which are currently served by our subsidiaries. Further, there is a trend toward granting ETC status to wireless carriers. In July 2004, ACSW was granted ETC status in the MTA and ACSF study area and was subsequently ETC status in ACSA, ACSAK-Juneau, and ACSN-Glacier State study areas in November 2004. ACSW was also granted ETC status in the areas serviced by the Copper Valley Telephone Cooperative, Inc., and KPU Telecommunications in April, 2006.

Other state regulations

The RCA adopted regulations allowing some bundling of local exchange and intrastate interexchange services. Other RCA rules, however, result in limitations on our ability to actually bundle our intrastate interexchange services.

The RCA has also opened dockets in 2005 to consider: the need to promulgate regulations to establish an affordability benchmark for local exchange telephone service, and to address whether and how to use state universal service funds to offset potentially unaffordable local exchange rates; the need to promulgate ETC regulations; and generally accepted industry standards for E911 service. All of these dockets, as well as the 2006 rulemakings previously mentioned, could impact our business.

Item 1A. Risk Factors

We face a variety of risks that may affect our business, financial condition, and results of operations, some of which are beyond our control. The risks described below are not the only ones we face and should be considered in addition to the other cautionary statements and risks described elsewhere, and the other information contained, in this report and in our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K. Additional risks and uncertainties not known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition and results of operations could be seriously harmed.

Risks related to our common stock

ACS Group is a holding company and relies on dividends, interest and other payments, advances and transfer of funds from its subsidiaries to meet its debt service and pay dividends.

ACS Group has no direct operations and no significant assets other than ownership of 100% of the stock of ACS Holdings, Inc. (ACSH). Because we conduct our operations through our direct and indirect subsidiaries, we depend on those entities for dividends and other payments to generate the funds necessary to meet our financial obligations, including paying dividends on our common stock. Legal restrictions applicable to our subsidiaries and contractual restrictions in our senior credit facility, and other agreements governing current and future debt of our subsidiaries, as well as the financial condition and operating requirements of our subsidiaries, may limit our ability to obtain cash from our subsidiaries. The earnings from, or other available assets of, our subsidiaries may not be sufficient to pay dividends on the common stock.

Our dividend policy may limit our ability to pursue growth opportunities.

Our board of directors has adopted a dividend policy which reflects an intention to distribute a substantial portion of the cash generated by our business in excess of operating needs, interest and principal payments on our debt and capital expenditures as regular quarterly dividends to our stockholders. As a result, we may not retain a sufficient amount of cash to finance a material expansion of our business, or to fund our operations consistent with past levels of funding. In addition, our ability to pursue any material expansion of our business, including through acquisitions or increased capital spending, will depend more than it otherwise would on our ability to obtain third party financing. Financing may not be available to us at an acceptable cost, or at all.

You may not receive the level of dividends provided for in our dividend policy or any dividends at all.

We are not obligated to pay dividends. Our board of directors may, in its absolute discretion, amend or repeal the 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 applicable law, and other factors that our board of directors may deem relevant. Additionally, Delaware law and the terms of our senior credit facility may reduce or eliminate our ability to pay dividends.

We might not generate sufficient cash from operations in the future to pay dividends on our common stock in the intended amounts, or at all. Our board of directors may decide not to pay dividends at any time and for any reason. If our cash flows from operations for future periods were to fall below our minimum expectations, we would need either to reduce or eliminate dividends or, to the extent permitted under the terms of our senior credit facility or any future agreement governing our debt, fund a portion of our dividends with borrowings or from other sources. If we were to use working capital or permanent borrowings to fund dividends, we would have less cash and/or borrowing capacity available for future dividends and other purposes, which could negatively affect our financial condition, results of operations, liquidity, ability to maintain or expand our business, and ability to fund dividends. Our board is free to depart from or change our dividend policy at any time and could do so, for example, if it were to determine that we had insufficient cash to take advantage of growth opportunities. The reduction or elimination of dividends may cause the market price of our common stock to decline.

Our substantial debt could adversely affect our financial health and restrict our ability to pay dividends on our common stock and adversely affect our financing options and liquidity position.

We have a substantial amount of debt. As of December 31, 2006 we had total long-term obligations, including current portion, of $438.2 million and net income for the year ended December 31, 2006 of $20.0 million.

Our debt could have important consequences for you as a holder of our common stock. For example, our substantial debt could:

- require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, future business opportunities and other general corporate purposes;

limit our flexibility to plan, adjust or react to changing economic, market or industry conditions, reduce our ability to withstand competitive pressures, and increase our vulnerability to general adverse economic and industry conditions;

place us at a competitive disadvantage to many of our competitors who are less leveraged than we are;

limit our ability to borrow additional amounts for working capital, capital expenditures, future business opportunities, including strategic acquisitions, and other general corporate requirements or hinder us from obtaining such financing on terms favorable to us or at all; and

limit our ability to refinance our debt.

The terms of our senior credit facility and the terms of our other debt allows us and our subsidiaries to incur additional debt upon the satisfaction of certain conditions. If new debt is added, the related risks described above would intensify.

Our debt instruments include restrictive and financial covenants that limit our operating flexibility.

Our senior credit facility requires us to maintain certain financial ratios and adhere to other covenants that, among other things, restrict our ability to take specific actions, even if we believe such actions are in our best interest. These include restrictions on our ability to:

pay dividends or distributions on, redeem or repurchase our capital stock;.

issue certain preferred or redeemable capital stock;

incur additional debt;

create liens;

make certain types of investments, loans, advances or other forms of payments;

issue, sell or allow distributions on capital stock of specified subsidiaries;

prepay or defease specified debt;

enter into transactions with affiliates; or

merge, consolidate or sell our assets.

These restrictions could limit our ability to obtain financing, make acquisitions or fund capital expenditures, withstand downturns in our business or take advantage of business opportunities. A breach of any of these covenants, ratios or tests could result in a default under our senior credit facility. Upon the occurrence of an event of default under our senior credit facility, the lenders could elect to declare all amounts outstanding under our senior credit facility to be immediately due and payable. Such a default or acceleration may allow our other creditors to accelerate our other debt. If the lenders accelerate the payment of the debt under our senior credit facility, our assets may not be sufficient to repay in full this debt and our other debt.

We will require a significant amount of cash to service our debt, pay dividends and fund our other liquidity needs. Our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on and to refinance our debt, including amounts borrowed under our senior credit facility, to pay dividends, and to fund planned capital expenditures and any strategic acquisitions we may make, if any, will depend on our ability to generate cash in the future. We cannot assure you that our business will generate sufficient cash flow from operations such that our currently anticipated growth in revenues and cash flow will be realized on schedule or that future borrowings will be available to us in an amount sufficient to enable the repayment of our debt, pay dividends or to fund our other liquidity needs. We may need to refinance all or a portion of our debt, including the senior credit facility, on or before maturity. We may not be able to refinance any of our debt on commercially reasonable terms or at all. If we are unable to refinance our debt or obtain new financing under these circumstances, we would have to consider other options, including:

- sales of certain assets to meet our debt service requirements;
- sales of equity; and
- negotiations with our lenders to restructure the applicable debt.

If we are forced to pursue any of the above options our business and/or the value of our common stock could be adversely affected.

We may issue shares of our common stock or other securities from time to time as consideration for future acquisitions and investments. In the event any such acquisition or investment is significant, the number of shares of our common stock, or the number or aggregate principal amount, as the case may be, of other securities that we may issue may be significant. We may also grant registration rights covering those shares or other securities in connection with any such acquisitions and investments.

Possible volatility in the price of our common stock could negatively affect us and our stockholders.

The trading price of our common stock may be volatile in response to a number of factors, many of which are beyond our control, including actual or anticipated variations in quarterly financial results, actual or anticipated variations in our dividend policy, changes in financial estimates by securities analysts, and announcements by our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments. In addition, our financial results or dividend payments may be below the expectations of securities analysts and investors. If this were to occur, the market price of our common stock could decrease, perhaps significantly. Additionally, historically, there has been a limited public market for our common stock. The limited liquidity for holders of our common stock may add to the volatility of the trading price of our common stock. These effects could materially adversely affect the trading market and prices for our common stock, as well as our ability to issue additional securities or to secure additional financing in the future.

In addition, the U.S. securities markets have experienced significant price and volume fluctuations. These fluctuations often have been unrelated to the operating performance of companies in these markets. Broad market and industry factors may negatively affect the price of our common stock, regardless of our operating performance.

The limited liquidity of the trading market for our common stock may affect the trading price of our common stock.

The trading market for our common stock is limited and a more liquid trading market for our common stock may not develop. It is more likely for common stock issued in larger aggregate numbers of shares to trade more favorably than similar common stock issued in smaller aggregate numbers because of the increased liquidity created by higher trading volumes resulting from larger numbers of traded shares. There may not be a sufficiently liquid market for our common stock for holders to sell common stock readily.

Limitations on usage of our net operating losses, and other factors requiring us to pay cash taxes in future periods, may affect our ability to pay dividends to you.

The disposition of a substantial number of shares of our common stock by a major stockholder in 2005 and 2006 held by it caused us to undergo an ownership change for purposes of Section 382 of the Internal Revenue Code. As a result, our ability to use our substantial net operating losses to offset taxable income for taxable periods ending after the disposition is limited. Consequently, in the future we may be required to pay cash income taxes because of limitations on using our net operating losses, or because all of our net operating losses have been used or have expired. Any of the foregoing would have the effect of increasing our taxable income and potentially reducing our after-tax cash flow available for payment of dividends in future periods, and may require us to reduce dividend payments on our common stock in such future periods.

Risks related to our business

We provide services to our customers over access lines and if we continue to lose access lines our revenues, earnings and cash flow from operations may decrease.

Our business generates revenue by delivering voice and data services over access lines. We have experienced net access line loss over the past few years, and during the year ended December 31, 2006, the number of access lines we serve declined by 6.73% due to increased competition and the introduction of DSL and cable modems. We may continue to experience net access line loss in our markets for an unforeseen period of time. In addition, GCI, the dominant cable television operator, aggressively offers competitive local telephone service in many of our largest markets. Our petition for forbearance from the requirement to provide UNEs in Anchorage has not been approved on terms we find acceptable, and we are appealing the FCC s ruling. In any event, we expect to experience continued access line loss in areas served by this competitor, and other competitors. Our inability to retain access lines would adversely affect our revenues, earnings and cash flow from operations.

Our business is subject to extensive governmental legislation and regulation. Applicable federal and state legislation and regulations and changes to them could adversely affect our business.

We operate in a heavily regulated industry, and most of our revenues come from the provision of services regulated by the FCC, and the RCA. Laws and regulations applicable to us and our competitors may be, and have been, challenged in the courts, and could be changed by legislation or regulatory orders at any time. Future developments or changes to the regulatory environment, or the effect of such developments or changes, may have an adverse effect on us.

There are a number of FCC and RCA rules under review that could have a significant effect on us. For example, many of the FCC s rules with regard to the provisioning of UNEs and other interconnection rules have been revised from time to time and are subject to further proceedings at the FCC. Several parties have challenged the FCC s current interconnection regulations in court, increasingly over its own facilities. Court rulings, further FCC actions, or new legislation in this area could affect our obligation to provide UNEs and the prices we receive for our UNEs. Changes to intercarrier compensation or the roaming agreements between wireless operators that affect our access or roaming revenues are also likely over the next few years. The FCC and Congress are also looking at universal service fund contribution and disbursement rules that are likely to affect the amount and timing of our contributions to and receipt of universal service funds; our obligations may increase and/or our revenue may decline; and our competitors may receive greater payments. Further, most FCC and RCA telecommunications decisions are subject to substantial delay and judicial review. These delays and related litigation create risk associated with uncertainty over the final direction of federal and state policies and our regulated rates.

As the incumbent local exchange carrier in our service areas, we are subject to legislation and regulation that are not applicable to our competitors.

Existing federal and state rules impose obligations and limitations on us, as the incumbent local telephone company, that are not imposed on our competitors. Federal obligations to share facilities, file and justify tariffs, maintain certain types of accounts, and file certain types of reports are all examples of disparate regulation. Similarly, state regulators impose accounting and reporting requirements and service obligations on us that do not exist for our competitors. In addition, state regulators have imposed greater tariffing standards and obligations on us than on our competitors. Some of our proposed tariffs may be suspended for six to twelve months before they go into effect, which has enabled our competitors to plan competitive responses before we are able to implement new rates, diminishing our ability to compete. As our business becomes increasingly competitive, the continued regulatory disparity could have a material adverse effect on our business.

A reduction by the RCA or the FCC of the rates we charge our customers would reduce our revenues and earnings.

The rates we charge our local telephone customers are based, in part, on a rate of return authorized by the RCA on capital invested in our networks. These authorized rates, as well as allowable investment and expenses, are subject to review and change by the RCA at any time. If the RCA orders us to reduce our rates, both our revenues and our earnings will be reduced. Additionally, in this competitive market, we are not sure we would be able to implement higher rates even if approved by the RCA.

State regulators may rebalance our planned rates or set new rates closer to our costs, and refuse to keep our sensitive business information confidential, furthering our competitive disadvantage in the marketplace. Our local exchange service competitors may also gain a competitive advantage as a result of the state regulators permitting our competitors to intervene in rate-setting proceedings.

FCC regulations also affect rates that are charged to customers. The FCC regulates tariffs for interstate access and subscriber line charges, both of which are components of our network service revenue. The FCC currently is considering proposals to reduce interstate access charges for carriers like us. If the FCC lowers interstate access charges without adopting an adequate revenue replacement mechanism, we may be required to recover more revenue through subscriber line charges and universal service funds or forego this revenue altogether. This could reduce our revenue or impair our competitive position.

Increased bandwidth consumption by customers using our data services may result in increased costs to us for wholesale network capacity, and we may be unable to recover those costs in our retail prices.

Consistent with national trends, data customers using our network have generally increased their individual consumption of network bandwidth over time. We believe demand for bandwidth will likely continue to increase as applications requiring ever-increasing data transfer rates, such as streaming video, gaming, and other Internet services, gain popularity. At the same time, retail pricing for bandwidth has remained flat or has decreased. Further, our proprietary data network has limited capacity in certain areas, and in those areas, we must purchase supplemental capacity from third-parties, including from our competitors. Thus, while our bandwidth needs are likely to grow, we may not be able to obtain additional capacity from wholesale providers at acceptable prices or at all. Consequently, our data services margins may decline or our service levels may fail to keep pace with consumer demands, which would adversely affect our reputation, business, and results of operations.

Loss of the exemption from certain forms of competition granted to one of our rural local exchange carriers under the Federal Telecommunications Act of 1996 exposes us to increased competition.

ACSN currently has a rural exemption from the requirement to provide UNEs to CLECs, but it remains subject to petitions for termination or facilities-based competition at any time. GCI was granted, subject to certain conditions, approval to provide local exchange telephone service in ACSN s Glacier State study area. New facilities-based local exchange service competition will likely reduce our revenues and return.

Interconnection duties are governed by telecommunications rules and regulations related to the UNEs that must be provided. These rules and regulations remain subject to ongoing change. In addition, to the extent that rural exemptions are terminated, other carriers are entitled to obtain interconnection agreements with us on the same basis as GCI. Finally, to the extent the new rates are higher than the previous rates, GCI or other competitors may provide service over their own facilities, further depriving us of revenue.

Our results of operations could be materially harmed as GCI further develops its own network facilities and stops leasing our network elements.

GCI commenced offering cable telephony in Anchorage during 2004 and has increasingly moved its customers off of our network and onto its own cable system. GCI announced plans to migrate virtually all of its Anchorage customers to its own network during 2007 and 2008. Significant migration of customers would result in a significant reduction of revenue for us, as GCI would no longer be leasing our facilities to serve those customers, which could materially harm our results of operations.

We derive a significant portion of our wireless revenue from roaming charges. This revenue may fluctuate or decline in the future as a result of general economic, contractual, and competitive factors.

Approximately 4% of our revenue for the year ended December 31, 2006 was derived from roaming charges incurred by other wireless providers whose customers traveled within our coverage areas. The revenue we recognize from these roaming charges may in the future be volatile or decline as a result of a number of factors, many of which are outside our control. These factors include, the strength of Alaskan economy and its primary industries, including tourism, general economic factors affecting commerce between Alaska and other States and countries, unresolved political matters which may affect public and private spending in Alaska, and others. For example, our service areas include a number of summer tourist destinations in Alaska; as a result, our roaming revenue generally increases during summer months and declines during other periods and depends heavily in these areas on the number of tourists who visit Alaskan tourist destinations. In addition, we cannot assure you our roaming agreements with other providers will continue to generate similar roaming revenues. Our agreements with other carriers have varying terms of varying length, including some which are terminable on short notice. In the event these roaming agreements expire or are terminated, we may be unable to renegotiate or replace these agreements on similar or acceptable terms. Failure to obtain acceptable roaming agreements could lead to a significant decline in our revenue and operating income. Lastly, changes in the network footprints of our roaming partners, or those of our competitors who are able to provide roaming coverage in our service areas, could have a material adverse effect on us.

Table of Contents

The telecommunications industry is extremely competitive, particularly in Alaska, and we may have difficulty competing effectively for share in generally small markets.

The telecommunications industry in Alaska is extremely competitive, and providers compete over a small number of customers in small markets. We face competition in local voice, local high-speed data and wireless, Internet, long distance and video services. Competitors in our markets:

- reduce our customer base;
- require us to lower rates and other prices in order to compete;
- require us to invest in new facilities and capabilities
- increase marketing expenditures and require the use of discounting and promotional campaigns that would adversely affect our margins; or
- otherwise lead to reduced revenues, margins, and returns.

We face strong competition from GCI in many areas for integrated, facilities-based, voice, broadband and video services, and GCI has been increasingly been providing these integrated services over its own facilities via cable telephony. New competitors in local services may be encouraged by FCC and RCA rules regarding interconnection agreements and universal service supports. We face competition from wireless service providers for local, long distance and wireless customers. One of our competitors provides wireless data at 1xRTT speeds in addition to wireless voice services.

Wireline-to-wireless and wireless-to-wireless number portability increases risk of wireless substitution for traditional local telephone services and increased competition among wireless carriers. In addition, carriers offering VoIP services may also lead to a reduction in traditional local and long distance telephone service revenues as well as our network access revenues. Some of our competitors may be exempt from or subject to lesser regulatory burdens.

Recent strategic investment among other Alaskan telecommunications providers may lead to increased competition and a different competitive landscape.

On December 22, 2006, the FCC approved an agreement by GCI, one of our primary competitors, to invest $29.5 million in Alaska DigiTel, one of our wireless competitors. The investment closed on January 1, 2007. In exchange for its investment, GCI received a majority equity interest in Alaska DigiTel. In addition to its equity investment, GCI entered into a revolving credit loan agreement with Alaska DigiTel. The loan agreement provides that Alaska DigiTel can draw up to $15.0 million. These transactions provide liquidity and cash to Alaska DigiTel to fund growth and operations that it may not otherwise have been able to afford. Growth by Alaska DigiTel could result in stronger competition in the statewide wireless market. This could have a material adverse effect on our business, operating results, and financial condition.

Revenues from our retail local telephone access lines may be reduced or lost.

As the incumbent local exchange carrier, we face stiff competition from resellers, local providers who lease UNEs from us, and other facilities-based providers of local telephone services. Through December 31, 2006, we have lost approximately 37% of our retail local telephone market share. In Anchorage, our largest market, since opening to competition, we have lost approximately 52% of our retail local telephone market share. Similarly, in Fairbanks and Juneau we have lost approximately 35% of our retail local telephone access lines. Further, our competitors may at any time bypass or remove these customers from our network completely, which would eliminate our revenue from those lines altogether. For example, GCI has already eliminated some revenue to us as a result of its deployment of cable telephony in Anchorage. We may not be successful in recovering those lost retail customers or revenues.

Revenues from access charges may be reduced or lost.

We received approximately 26% of our operating revenues for the year ended December 31, 2006 from local exchange network access charges. The amount of revenue that we receive from these access charges is calculated in accordance with requirements set by the FCC and the RCA. Any change in these requirements may reduce our revenues and earnings. Generally, access charges have decreased since our inception in 1999.

25

Table of Contents

Under the regulatory rules that exist today, we receive access revenue related to the calls made by all of our retail customers as well as our competitors customers who are served via resale of our services. Access revenue related to our competitors retail customers that are served by UNEs or by the competitors own facilities flows to our competitors. To the extent that competitors shift the form in which they provide service away from resale our access revenue will be reduced. We do not receive access revenue from VoIP calls, and growth of this service will reduce our access revenues.

The FCC is reviewing new mechanisms for intercarrier compensation. Some parties have suggested terminating all interstate access charge payments by interexchange carriers with alternative compensation methods for providers of access services. If such a proposal is adopted, it would likely have a material impact on our revenue and earnings. The FCC has stated its intent to adopt some form of access charge reform soon, which more likely than not will reduce this source of revenue. Similarly, the RCA has adopted regulations modifying intrastate access charges that may reduce our revenue.

In addition, we have from time to time been involved in disputes we believe will relate to interstate access revenue. We cannot assure you that claims alleging excess charges will not be made in the future, nor that we will be able to defeat such claims.

A reduction in the universal service support currently received by some of our subsidiaries would reduce our revenues and earnings.

We received approximately 8.8% of our operating revenues for the year ended December 31, 2006 from the USF. The USF was established under the direction of the FCC to compensate carriers for the high cost of providing universal telecommunications services in rural, insular, and high-cost areas. If the support we receive from the USF is materially reduced or discontinued, some of our rural local exchange carriers as well as wireless providers might not be able to operate profitably. Also, because we provide interstate and international services, we are required to contribute to the USF a percentage of our revenue earned from such services. Although our rural LECs receive support from the USF, we cannot be certain of how, in the future, our contributions to the USF will compare to the support we receive from the USF.

Various reform proceedings are under way at the FCC to change the method of calculating the amount of contributions paid into the USF by all carriers and the amount of contributions or support rural carriers like ACSF, ACSAK and ACSN receive from the USF, as well as the amount of support received and contributions paid by our competitors. We cannot predict when or how any change in the method of calculating contributions and support may affect our business.

The RCA has granted ETC status to GCI in Fairbanks and Juneau. Under current FCC rules, ETC status entitles GCI to the same amount of per-line USF support that we are entitled to receive regardless of GCI s costs. To the extent that any competitive ETC, such as GCI, has lower costs than us, but receives the same amount of financial support, the competitor gains a competitive cost advantage over us. If this should occur, it could have an adverse effect on our ability to compete.

As for wireless carriers, Alaska DigiTel, ACS Wireless, Inc., or ACSW, MTA Wireless, and Dobson have been granted ETC status for certain areas.

Revenues from wireless services may be reduced.

Market prices for wireless voice and data services have declined over the last several years and may continue to decline in the future. We may be unable to maintain or improve our average revenue per user. We expect significant competition among wireless providers, which has been intensified by wireless number portability and may be spurred by additional spectrum auctions, to continue to drive service and equipment prices lower, which may lead to increased turnover of customers. If market prices continue to decline, our ability to grow revenue would be affected, which would have an adverse effect on our financial condition and results of operation. There can be no assurance that any advanced wireless services we offer will be profitable or increase average revenue per user.

We may not be able to offer long distance and Internet services on a profitable basis.

Our long distance operations have historically been modest in relation to the long distance businesses of our competitors. Our long distance operations generated income of $7.0 million in 2006, and $0.3 million for the year ended December 31, 2005. Our Internet operations generated operating losses of $8.9 million in 2006, and $6.4 million for the year ended December 31, 2005. Our operating losses from long distance and Internet services may increase in the future, even after taking into account additional revenue from complementary or advanced services.

If we substantially underestimate or overestimate the demand for our long distance services, our cost of providing these services would increase.

We expect to continue to enter into resale agreements for a portion of our long distance services. In connection with these agreements, we must estimate future demand for our long distance service. If we overestimate this demand, we may be forced to pay for services we do not need, and if we underestimate this demand, we may need to lease additional capacity on a short-term basis at unfavorable prices, assuming additional capacity is available. If additional capacity is not available, we would not be able to meet this demand.

If we do not adapt to technological changes in the telecommunications industry, we could lose customers or market share.

Our success will likely depend on our ability to adapt to rapid technological changes in the telecommunications industry. Our failure to adopt a new technology or our choice of one technology over another may have an adverse effect on our ability to compete or meet the demands of our customers. Technological change could, among other things, reduce the barriers to entry facing our competitors providing local service in our service areas. The pace of technology change and our ability to deploy new technologies may be constrained by insufficient capital and/or the need to generate sufficient cash to make interest payments on our debt and to maintain our dividend policy.

New products and services may arise out of technological developments and our inability to keep pace with these developments may reduce the attractiveness of our services. If we fail to adapt successfully to technological changes or fail to obtain access to new technologies, we could lose customers and be unable to attract new customers and/or sell new services to our existing customers. We may be unable to successfully deliver new products and services, and we may not generate anticipated revenues from such products or services.

New governmental regulations may impose obligations on us to upgrade our existing technology or adopt new technology that may require additional capital and we may not be able to comply timely with these new regulations.

We cannot predict the extent the government will impose new unfunded mandates on us. Such mandates include those related to emergency location, providing access to hearing-impaired customers, law enforcement assistance, and local number portability. Each of these government mandates has imposed new requirements for capital that we could not have predicted with any precision. Along with these obligations, the FCC has imposed deadlines for compliance with these mandates. We may not be able to provide services that comply with these mandates in time to meet the imposed deadlines. Further, we cannot predict whether other mandates, from the FCC or other regulatory authorities, will occur in the future or the demands they may place on our capital expenditures.

Our network capacity and customer service system may not be adequate and may not expand quickly enough to support our anticipated customer growth.

Our financial and operational success depends on ensuring that we have adequate network capacity, sufficient infrastructure equipment and a sufficient customer support system to accommodate anticipated new customers and the commensurate increase in usage of our network. Our failure to expand and upgrade our networks, including obtaining and constructing additional cell sites, obtaining wireless telephones of the appropriate model and type to meet the demands and preferences of our customers, and obtaining additional spectrum to meet the increased usage, could have a material adverse effect on our business. Further, as a result of our dividend policy, our available cash to expand and upgrade our network may be limited.

Table of Contents

The reduction in our regulated rate base may adversely affect our ability to price our services.

For the last several years, our depreciation has exceeded our capital investment. As a result, our rate base, used to price our regulated services, is in decline. Our service rates for our local telephone services, for example, are determined by calculating a reasonable rate of return on and to our rate base. Thus, a declining rate base leads to declining rates and prices for our regulated services, which may adversely affect our cash flow and results of operations.

The successful operation and growth of our businesses depends on economic conditions in Alaska.

Substantially all of our customers and operations are located in Alaska. Due to our geographical concentration, the successful operation and growth of our businesses depends on economic conditions in Alaska. The Alaskan economy, in turn, depends upon many factors, including:

- the strength of the natural resources industries, particularly oil production;
- the strength of the Alaskan tourism industry;
- the level of government and military spending; and
- the continued growth of services industries.

The customer base for telecommunications services in Alaska is small and geographically concentrated. According to U.S. Census Bureau estimates, the population of Alaska is approximately 670,000 as of July 1, 2006, approximately 60% of whom live in Anchorage, Fairbanks and Juneau. We do not know whether Alaska s economy will grow or even be stable.

We depend on key members of our senior management team.

Our success depends largely on the skills, experience and performance of key members of our senior management team, as well as our ability to attract and retain other highly qualified management and technical personnel. There is intense competition for qualified personnel in our industry, and we may not be able to attract and retain the personnel necessary for the development of our business. If we lose one or more of our key employees, our ability to successfully implement our business plan could be materially adversely affected. We do not maintain any key person insurance on any of our personnel.

We rely on a limited number of key suppliers and vendors for timely supply of equipment and services for our network infrastructure. If these suppliers or vendors experience problems or favor our competitors, we could fail to obtain sufficient quantities of the equipment and services we require to operate our business successfully.

We depend on a limited number of suppliers and vendors for equipment and services for our network. If these suppliers experience interruptions, patent litigation, or other problems, subscriber growth and our operating results could suffer. If our supplier uses its proprietary technology, including CDMA technology, as an integral component of our network, we may be effectively locked into one or few suppliers for key network components. As a result, we have become reliant upon a limited number of network equipment manufacturers. In the event it becomes necessary to seek alternative suppliers and vendors, we may be unable to obtain satisfactory replacement suppliers or vendors on economically attractive terms on a timely basis, or at all, which could increase costs and may cause disruption in service.

Wireless devices may pose health and safety risks and driving while using a wireless phone may be prohibited; as a result, we may be subject to new regulations, and demand for our services may decrease.

Media reports have suggested that, and studies have been undertaken to determine whether, certain radio frequency emissions from wireless handsets and cell sites may be linked to various health concerns, including cancer. Further, radio frequency emissions may interfere with various electronic medical devices, including hearing aids and pacemakers. In addition, lawsuits have been filed against others in the wireless industry alleging various adverse health consequences as a result of wireless phone usage.

If consumers health concerns over radio frequency emission increase, they may be discouraged from using wireless handsets; regulators may impose or increase restrictions on the location and operation of cell sites or increase regulation on handsets; and wireless providers may be exposed to litigation, which, even if not successful, may be costly to

defend. The actual or perceived risk of radio frequency emissions could adversely affect us through a reduced subscriber growth rate, a reduction in our subscribers, reduced network usage per subscriber, or reduced financing available to the wireless communications industry.

In addition, new government regulations on the use of a wireless device while driving may adversely affect our results of operations. Studies have indicated that using wireless devices while driving may impair a driver s attention. Many state and local legislative bodies have passed or proposed legislation to restrict the use of wireless telephones while driving motor vehicles. Concerns over safety and the effect of future legislation, if adopted and enforced in the areas we serve, could limit our ability to market and sell our wireless services and decrease our revenue from customers who now use their wireless telephones while driving. Further, litigation relating to accidents, deaths or serious bodily injuries allegedly incurred as a result of wireless telephone use while driving could result in damage awards against telecommunications providers, adverse publicity and further governmental regulation. Any of these results could have a material adverse effect on our results of operations and financial condition.

We are subject to environmental regulation and environmental compliance expenditures and liabilities.

Our business is subject to many environmental laws and regulations, particularly with respect to owned or leased real property containing our network equipment and tower sites. Some or all of the environmental laws and regulations to which we are subject could become more stringent or more stringently enforced in the future. For example, the FCC is considering whether to adopt rules to reduce the incidents of migratory bird collisions with cell towers. Our failure to comply with applicable environmental laws and regulations and permit requirements could result in civil or criminal fines or penalties or enforcement actions, including regulatory or judicial orders enjoining or curtailing operations or requiring corrective measures, installation of pollution control equipment or remedial actions.

In addition to operational standards, environmental laws also impose obligations on us to clean up contaminated properties or pay for the costs of such clean up. We could become liable, either contractually or by operation of law, for such clean up costs even if the contaminated property is not currently owned or operated by us, or if the contamination was caused by third parties during or prior to our ownership or operation of the property. Moreover, future events, such as changes in existing laws or policies or their enforcement, or the discovery of currently unknown contamination, may give rise to material clean up costs.

A failure of our system or network cables could cause significant delays or interruptions of service, which could cause us to lose customers.

To be successful, we will need to continue to provide our customers reliable service over our network. In certain important cases, our systems lack redundancy, which reduces the reliability of our network. Our network and infrastructure are constantly at risk of physical damage to access lines or other inoperability as a result of human, natural, or other factors. These factors may include labor strikes, pandemics, acts of terrorism, sabotage, natural disasters, power surges or outages, software defects, contractor or vendor failure, and other disruptions that may be beyond our control. For example, should the primary fiber-optic cable connecting our Alaskan network to the lower 48 states become damaged or otherwise inoperable, services on our network to the lower 48 states and beyond would likely be degraded or unavailable.

We rely heavily on our networks, network equipment, data and software and the networks of other telecommunications providers to support all of our functions and for substantially all of our revenues. We are able to deliver services only to the extent that we can protect our network systems against damage from power or telecommunication failures, computer viruses, natural disasters, unauthorized access and other disruptions. While we endeavor to provide for failures in the network by providing back-up systems and procedures, we cannot guarantee that these back-up systems and procedures will operate satisfactorily in an emergency.

Should we experience a prolonged system failure or a significant service interruption, our customers may choose a different provider, and our reputation may be damaged.

A failure of enhanced emergency calling services associated with our network may harm our business.

We provide E911, service to our customers where such service is available. We also contract from time to time with municipalities to upgrade their public safety answering points such that those facilitates become capable of receiving our transmission of a 911 caller s location information and telephone number. If the emergency call center is unable to process such information, the caller is provided only basic 911 services. In these instances, the emergency caller may be required to verbally advise the operator of such caller s location at the time of the call. Any inability of the answering point to automatically recognize the caller s location or telephone number whether or not it occurs as a result of our network operations may cause us to incur liability or cause our reputation or financial results to suffer.

We cannot assure you that we will be able to successfully integrate any acquisitions we may make in the future.

We continually explore acquisitions. However, any future acquisitions we make may involve some or all of the following risks:

- diversion of management attention from operating matters;
- unanticipated liabilities or contingencies of acquired businesses;
- failure to achieve projected cost savings or cash flow from acquired businesses;
- inability to retain key personnel of the acquired business or maintain relationships with its customers;
- inability to successfully integrate acquired businesses with our existing businesses, including information-technology systems, personnel, products and financial, computer, payroll and other systems of the acquired businesses;
- failure to obtain necessary regulatory approvals;
- difficulties in enhancing our customer support resources to adequately service our existing customers and the customers of the acquired businesses; and
- difficulty in maintaining uniform standards, controls, procedures, and policies.

Further, as a result of our dividend policy and other factors which affect the availability to us of capital resources, we may not have sufficient available cash or access to sufficient capital resources necessary to complete a transaction even if such a transaction would otherwise be beneficial to us and our stockholders.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

At December 31, 2006, our telecommunications network includes approximately 1,070 sheath miles of fiber-optic cable, approximately 200 switching facilities and a statewide wireless network. In addition, we own fiber capacity for high-speed links within Alaska and for termination of traffic in the continental United States. We plan to continue enhancing our network to meet customer demand for increased bandwidth and advanced services. See Item 1 Business Network and Technology

We own approximately 364,000 square feet of facilities in Anchorage, Alaska; which includes our corporate headquarters. We also own or lease facilities in our service areas across Alaska. We believe this space is sufficient for us to conduct our business.

Substantially all of our assets (including those of our subsidiaries) have been pledged as collateral for our 2005 senior credit facility.

Local telephone. Our primary local telephone properties consist of approximately 200 switching facilities. We own most of our administrative and maintenance facilities, customer service centers, central office and remote switching platforms and transport and distribution network facilities. Our local telephone assets are located in Alaska. Our transport and distribution network facilities include a fiber-optic backbone and copper wire distribution facilities that connect customers to remote switch locations or to the central office and to points of presence or interconnection with interexchange carriers. These facilities are located on land pursuant to permits, easements, right of ways or other agreements.

Wireless. We have five digital switching centers, approximately 194 cell locations and three repeaters covering substantially all major population centers and highway corridors in Alaska plus one analog switch and cell site covering Barrow, Alaska. We lease the land or tower space on which substantially all the sites are located.

Internet. We own or lease point of presence facilities that permit our dial-up and DSL customers to access the Internet in more than 30 communities serving the majority of Alaska s populated areas. These communities are linked to the Internet in Seattle, Washington over both owned and leased facilities.

Interexchange. We are a facilities-based interexchange carrier. We have invested in fiber-optic capacity through IRUs that provides bandwidth between our Anchorage, Fairbanks, and Juneau locations and Seattle, Washington. We also lease transport facilities and have arrangements with other interexchange carriers to terminate traffic in the lower 48 states.

Item 3. Legal Proceedings

We are involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business, including various legal proceedings involving regulatory matters described under Item 1 Business Regulation. We have recorded litigation reserves of $0.1 million as of December 31, 2006 against certain current claims and legal actions. 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.

The information set forth under Note 20 Commitments and Contingencies in the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report, and is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled Risk Factors in Item 1A of this Report.

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Our common stock is traded on the Nasdaq National Market under the symbol ALSK . The following table presents, for the periods indicated, the high and low sales prices of our common stock as reported by the Nasdaq National Market.

2006 Quarters	High	Low
4th	$15.86	$13.10
3rd	$14.47	$11.51
2nd	$13.08	$11.00
1st	$12.63	$ 9.40

2005 Quarters	High	Low
4th	$11.79	$9.82
3rd	$11.90	$9.54
2nd	$10.42	$8.98
1st	$10.40	$7.81

As of February 26, 2007, there were 42,349,801 shares of our common stock issued and outstanding and approximately 305 record holders of our common stock. Because many of our shares of existing common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Dividends

On October 28, 2004, we announced the adoption of a dividend policy by our board of directors and declared our first quarterly dividend of $0.185 per share, which was paid on January 19, 2005 to holders of record on December 31, 2004. Prior to announcing this dividend, we had no history of paying dividends. On March 21, 2005, our board of directors declared a quarterly cash dividend, of $0.20 per share, an increase over the prior quarterly cash dividend of approximately 8%. This dividend payment applied to holders of record on March 31, June 30, September 30, 2005 and December 29, 2005. In February 2006, we announced that our board of directors increased our dividend policy to an annual rate of $0.86 per share, an increase of 7.5% over the previous annual rate of $0.80 per share. On February 22, June 15, September 15 and December 15, 2006 a dividend of $0.215 per share was declared.

Based on approximately 42.3 million shares outstanding on February 26, 2007, we estimate dividends payable during 2007 to be approximately $36.4 million.

Our ability to make dividend payments in the future will depend on future economic conditions and on financial, business, regulatory and other factors, many of which are beyond our control. Accordingly, our board of directors may modify or revoke this policy at any time. Thus, you may not receive any dividends. Factors that may affect our dividend policy are:

- we are a holding company and rely on dividends, interest and other payments, advances and transfer of funds from our subsidiaries to meet our debt service and pay dividends;
- we may not have enough cash to pay dividends due to changes in our operating earnings, working capital requirements and anticipated cash needs;
- nothing requires us to declare or pay dividends;
- while the dividend policy adopted by our board of directors reflects an intention to distribute a substantial portion of our cash generated by our business in excess of operating needs, interest and principal payments on debt and capital expenditures, to pay dividends, our board could modify or revoke this policy at any time;

Table of Contents

- even if our dividend policy is not modified or revoked, the actual amount of dividends distributed under the policy and the decision to make any distribution will remain, at all times, entirely at the discretion of our board of directors;

- the amount of dividends that we may distribute will be limited by restricted payment and leverage covenants in our new senior credit facility, and potentially, the terms of any future debt that we may incur;

- the amount of dividends that we may distribute is subject to restrictions under Delaware law; and

- our stockholders have no contractual or other legal right to dividends.

See Item1A Risk Factors Risks related to our common stock . You may not receive the level of dividends provided for in our dividend policy or any dividends at all.

Securities Authorized for Issuance under Equity Compensation Plans

The information set forth in this Report under Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters Securities Authorized for Issuance under Equity Compensation Plans is incorporated herein by reference. For additional information on our stock incentive plans and activity, see Note 13 Stock Incentive Plans in the Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report.

Item 6. Selected Financial Data

SELECTED HISTORICAL FINANCIAL DATA

The following table sets forth our historical consolidated financial data as of December 31, 2006, 2005, 2004, 2003 and 2002 and for the fiscal years ended December 31, 2006, 2005, 2004, 2003 and 2002, which are derived from our audited financial statements for those years.

The selected historical financial data set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes thereto for the years ended December 31, 2006, 2005, 2004, 2003 and 2002.

($ in thousands)	2006	2005	2004	2003	2002
Operating Data:					
Operating revenues	$349,817	$326,809	$302,707	$323,847	$340,394
Income/(loss) from continuing operations	19,994	(41,635)	(39,294)	(6,578)	(72,265)
Income/(loss) from continuing operations per share basic	$ 0.48	$ (1.04)	$ (1.33)	$ (0.22)	$ (2.30)
Cash dividends per share	0.86	0.80	0.19		
Balance Sheet Data (end of period):					
Total assets	$562,321	$576,413	$637,127	$685,391	$752,509
Long-term debt, including current portion	438,213	445,578	525,889	550,220	607,763

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and the other financial information included elsewhere in this Form 10-K.

Alaska Communications Systems Group

We generate revenue primarily through:

- The provision of local telephone services, including:
  - o Basic local service to retail customers within our service areas,

- Wholesale service to CLECs,

- o Network access services to interexchange carriers for origination and termination of interstate and intrastate long distance phone calls,
- o Enhanced services,
- o Ancillary services, such as billing and collection, and
- o Universal service payments;

The provision of wireless services;

The provision of Internet services; and

The provision of interexchange network long distance and data services.

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

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

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

intrastate and interstate revenue settlement methodologies;

authorized rates of return for regulated services;

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

intrastate and interstate calling patterns;

customers selection of various local rate plan options;

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

other subscriber usage characteristics.

LECs have three basic tiers of customers:

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

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

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

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

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

Wireless We are the second largest statewide provider of wireless services in Alaska, currently serving approximately 134,000 subscribers. Our wireless network footprint covers over 542,000 residents, including all major population centers and highway and ferry corridors. We offer wireless services primarily on our digital network known as CDMA 1xRTT, which provides customers with improved voice call quality, average mobile data speeds of 70-80kbps and provides a platform for the launch of enhanced services. We offer mobile wireless broadband service based on EV-DO which enables high speed data connectivity with speeds that burst up to 2mbps to our wireless markets in Anchorage, Fairbanks, and Juneau. We estimate that the new CDMA service currently covers 81% of the State s population of approximately 670,000.

Internet We are the second largest provider of Internet access services in Alaska with approximate 57,000 customers. We offer dial-up and dedicated DSL Internet access to our customers. We are a single source provider of advanced IP based private networks in Alaska.

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

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

Critical accounting policies and accounting estimates

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

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

We use an allowance method to estimate the net realizable value of accounts receivable. As of December 31, 2006 and December 31, 2005, the allowance for doubtful accounts receivable was $7.4 million and $6.2 million, respectively. Actual collection results could vary significantly from management s estimate.

Access revenue is recognized when earned. We participate in access revenue pools with other telephone companies. Such pools are funded by toll revenue and/or access charges regulated by the RCA within the intrastate jurisdiction and the FCC within the interstate jurisdiction. Much of the interstate access revenue is initially recorded based on estimates. These estimates are derived from interim financial statements, available separations studies and the most recent information available about achieved rates of return. These estimates are subject to adjustment in future accounting periods as additional operational information becomes available. To the extent that disputes arise over revenue settlements, our policy is to defer revenue collected until settlement methodologies are resolved and finalized. At December 31, 2006, we had recorded liabilities of $21.4 million related to our estimate of refundable access revenue. Actual results could vary from this estimate.

We utilize the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred taxes reflect the temporary differences between the financial and tax basis of assets and liabilities using the enacted tax rates in effect in the years in which the differences are expected to reverse. Net deferred tax assets are reduced by a valuation allowance to the extent that it is more likely than not that such net deferred tax asset will not be realized. The cumulative valuation allowance against net deferred tax assets was $120.5 million as of December 31, 2006, which represents 100% of net deferred tax assets.

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

We implemented, effective January 1, 2003, higher depreciation rates for our regulated telephone plant for the interstate jurisdiction, which we believe approximates the economically useful lives of the underlying plant. As a result, we have recorded a regulatory asset under SFAS No. 71 of $65.7 million and $52.6 million as of December 31, 2006 and 2005, respectively, related to depreciation of the regulated telephone plant allocable to our intrastate and local jurisdictions. If we were not following SFAS No. 71, these costs would have been charged to expense as incurred. We also have a regulatory liability of $61.5 million and $58.2 million at December 31, 2006 and 2005, respectively, related to accumulated removal costs on the local exchange subsidiaries. If we were not following SFAS No. 71, we would have followed SFAS No. 143 for asset retirement obligations associated with our regulated telephone plant. SFAS No. 71 also requires revenue and costs generated between regulated and non-regulated companies not be eliminated on consolidation; these revenues and costs totaled $32.8 million and $32.2 million for the twelve months ended December 31, 2006 and 2005, respectively. Non-regulated revenues and costs incurred by our local telephone exchange operations and non-regulated operations are not accounted for under SFAS No. 71 principles.

Goodwill and indefinite-lived intangible assets are assessed for impairment on at least an annual basis. SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level upon adoption and at least annually thereafter, utilizing a two-step methodology. The initial step requires us to determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of such unit. If the fair value exceeds the carrying value, no impairment loss would be recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount, if any, of the impairment is then measured in the second step. We determined the fair value of each reporting unit for purposes of this test primarily by using a discounted cash flow valuation technique. Significant estimates used in the valuation include estimates of future cash flows, both future short-term and long-term growth rates, and estimated cost of capital for purposes of arriving at a discount factor. At December 31, 2006, we had recorded goodwill of $38.4 million applicable to our local telephone and wireless segments and intangible assets of $21.6 million related primarily to our wireless segment, of which none was considered impaired.

Effective January 1, 2005, we adopted SFAS No. 123(R), *Share-Based Payment,* which requires us to measure compensation cost for all outstanding unvested share-based awards at fair value and recognize compensation over the service period for awards expected to vest. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results may differ substantially from these estimates. As a result of the early adoption of SFAS No. 123(R), and the issuance of restricted stock, we recorded $6.9 million of stock-based compensation for the year ended December 31, 2006.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes. FIN 48 will be effective for us on January 1, 2007. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We are currently in the process of quantifying the impact FIN 48 will have on its financial position and results of operations.

In June 2006, FASB Emerging Issues Task Force (EITF) Issue No. 06-3, How Taxes Collected from Customers and Remitted to Government Authorities Should Be Presented in the Income Statement was issued. EITF 06-3 will be effective for accounting periods beginning after December 15, 2006. The consensus reached in this Issue is that the presentation of taxes on either a gross (included in revenue and costs) or a net (excluded from revenues) basis is an accounting policy decision and should be disclosed pursuant to Opinion 22. We currently present taxes on a gross basis and are in the process of quantifying the impact EITF No. 06-3 will have on our financial position and results of operations.

In September 2006, the FASB issued FASB Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. This statement requires an employer to recognize in its statement of financial position the over-funded or under-funded status of a defined benefit postretirement plan measured as the difference between the fair value of a plan s assets and the benefit obligation. Employers must also recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period. The Statement was effective for us on December 31, 2006. Adoption of this standard resulted in a decrease in our pension assets of $4.0 million, a decrease to our pension liability of $3.3 million and a decrease to other comprehensive income of $0.7 million. See Note 14 - Retirement Plans, to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements for additional disclosure information regarding the adoption of this standard.

Table of Contents

We are involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business, and have recorded litigation reserves of $0.1 million against certain claims and legal actions as of December 31, 2006. 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.

Results of Operations

The following table summarizes our company s operations for the years ended December 31, 2006, 2005 and 2004.

($ in thousands, except per share data)	2006	2005	2004
Operating revenues:			
Local telephone	$ 192,058	$ 202,842	$ 211,187
Wireless	115,584	86,235	56,694
Internet	25,221	21,672	20,173
Interexchange	16,954	16,060	14,653
Total operating revenues	349,817	326,809	302,707
Operating expenses:			
Local telephone (exclusive of depreciation and amortization)	130,178	126,982	127,918
Wireless (exclusive of depreciation and amortization)	62,022	49,407	37,918
Internet (exclusive of depreciation and amortization)	29,625	23,298	25,739
Interexchange (exclusive of depreciation and amortization)	12,633	17,314	19,773
Depreciation and amortization	63,259	82,819	78,387
Loss (gain) on disposal of assets, net	1,105	(152)	2,854
Total operating expenses	298,822	299,668	292,589
Operating income	50,995	27,141	10,118
Other income and expense:			
Interest expense	(40,753)	(70,776)	(51,064)
Interest income and other	10,178	1,983	1,417
Total other income (expense)	(30,575)	(68,793)	(49,647)
Income/(loss) before income taxes	20,420	(41,652)	(39,529)
Income tax benefit (expense)	(443)		219
Equity in income of investments	17	17	16
Net income/(loss)	$ 19,994	$ (41,635)	$ (39,294)
Net Income/(loss) per share:			

Basic	$ 0.48	$ (1.04)	$ (1.33)
Diluted	$ 0.46	$ (1.04)	$ (1.33)
Weighted average shares outstanding:			
Basic	42,045	40,185	29,592
Diltuted	43,387	40,185	29,592

Table of Contents

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Operating Revenue

Operating revenue increased $23.0 million, or 7.0%, for the year ended December 31, 2006 compared to the year ended December 31, 2005. Wireless, Internet and interexchange revenue increased compared to the corresponding period of 2005, while local telephone revenue decreased compared to the corresponding period of 2005.

Local Telephone. Local telephone revenue, which consists of local network service, network access and deregulated and other revenue, decreased $10.8 million, or 5.3%, for year ended December 31, 2006 compared to the same period in 2005. The following table summarizes our consolidated local telephone revenue by category:

	Year Ended December 31,	
	2006	**2005**
	(in thousands)	
Local telephone revenue:		
Local network service	$ 80,177	$ 86,482
Network access	90,894	92,379
Deregulated and other	20,987	23,981
Total local telephone revenue	$ 192,058	$ 202,842

The following table summarizes our local telephone access lines:

		As of December 31,	
		2006	**2005**
Retail access lines		194,815	199,341
Wholesale access lines		11,226	13,966
Unbundled network elements	loop (UNE-L)	39,568	50,875
Unbundled network elements	platform (UNE-P)	7,058	6,703
Total local telephone access lines		252,667	270,885

Local network service revenue decreased $6.3 million or 7.3% for the year ended December 31, 2006, compared to the year ended December 31, 2005. Access lines in service decreased 6.7% to 252,667, primarily reflecting the net effect of access line losses offset by increases in UNE rates and improved line mix. In November 2004 we received a final order from the RCA with respect to UNE-L rates for Anchorage, retroactive to June 2004, increasing the UNE-L rate from $14.92 to $18.64, and on January 1, 2005, rates increased for UNE-P and UNE-L in Fairbanks and Juneau from $19.19 to $23.00 and from $16.71 to $18.00, respectively.

Network access revenue decreased $1.5 million, 1.6%, for the year ended December 31, 2006, compared to the same period in 2005. Network access revenue is based on a regulated return on rate base and recovery of allowable expenses associated with the origination and termination of toll calls for our retail and resale customers. The decrease was primarily attributable to the decline in depreciation expense on the LECs and its effect on the interstate access and universal service fund studies. The decreases were offset in part by a $1.5 million settlement with interexchange carriers in the fourth quarter of 2006. We expect that network access revenue will decline as a component of local telephone revenue for the foreseeable future.

Deregulated and other revenue consists principally of billing and collection services, space and power rents, CPE, paystation revenue, regulated directory listing revenue, and other miscellaneous telephone revenue. Deregulated revenue decreased $3.0 million, or 12.5% for the year ended December 31, 2006, compared to the year ended December 31, 2005, as the result of a decrease in CPE sales and a decline in billing and collection revenue due to amended affiliate contracts.

Table of Contents

Consistent with the U.S. telecommunications industry trend, we experienced a loss of local telephone access lines as customers migrated to broadband Internet services reducing demand for second lines, migrated to cable telephony, or replaced landline service with wireless service. During 2004, our primary competitor began deploying cable telephony and switching its UNE-L provisioned subscribers over to its own network.

Wireless. Wireless revenue increased $29.3 million, or 34.0%, to $115.6 million for the year ended December 31, 2006 from $86.2 million for the year ended December 31, 2005. This increase is due primarily to the following:

- growth in subscribers year over year of 14.0% at December 31, 2006;
- an increase in average revenue per unit (ARPU), of 7.8% to $58.71 for the year ended December 31, 2006, from $54.45 for the year ended December 31, 2005, primarily as a result of improved subscriber mix with a higher proportion of post paid retail subscribers, increased plan revenue, feature revenue, roaming revenue, regulatory surcharges and receipt of CETC funding which added $9.49 and $7.33 to cellular ARPU in 2006 and 2005, respectively;
- higher revenue from non-ACS customers roaming on our network resulting in third-party roaming revenue increasing to $14.2 million from $6.7 million for the year ended December 31, 2006 and 2005, respectively.
- $2.4 million in out of period CETC funds received in the fourth quarter of 2006; and
- higher gross customer adds, handset upgrades and accessory sales in the year ended December 31, 2006 resulting in $8.2 million of revenue compared to $7.1 million for the year ended December 31, 2005.

Internet. Internet revenue increased $3.5 million, or 16.4%, for the year ended December 31, 2006 compared to the year ended December 31, 2005, primarily as a result of growth in sales of data services to commercial and government customers and DSL subscribers, which increased by 22.9% to 44,066 at December 31, 2006 from 35,884 at December 31, 2005, offset in part by a 27.6% reduction in dial-up subscribers to 12,591 at December 31, 2006.

Interexchange. Interexchange revenue increased $0.9 million, or 5.6%, for the year ended December 31, 2006 compared to the year ended December 31, 2005. Long distance subscribers increased 13.6% to 63,995 at December 31, 2006, from 56,317 at December 31, 2005 and annual minutes of use increased to 236.5 million for the year ended December 31, 2006, from 182.1 million for the year ended December 31, 2005. Minutes of use includes 117.4 million at December 31, 2006 compared to 65.4 million at December 31, 2005 of activity generated on our wireless network, with associated revenues recorded in our wireless segment.

Operating Expense

Operating expense decreased $0.9 million, or 0.3%, to $298.8 million for the year ended December 31, 2006, from $299.7 million for the year ended December 31, 2005. Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

Local Telephone. The components of local telephone expense are plant specific operations, plant non-specific operations, customer operations, corporate operations and property and other operating tax expense. Local telephone expense increased $3.2 million to $130.2 million for the year ended December 31, 2006 from $127.0 million for the year ended December 31, 2005. The increase in local telephone expense was the result of a number of factors. The increase in local telephone expense was substantially attributable to a $3.4 million increase in stock compensation expense and $2.4 million increase in labor costs primarily driven by higher incentive compensation. These expenses were offset by $1.1 million decrease in cost of goods sold related to sales of large E-911 systems in 2005 and by $1.4 million in IT and accounting, consulting and outside service fees for SOx compliance and audit work.

Wireless. Wireless expense increased $12.6 million, or 25.5%, for the year ended December 31, 2006 compared to the year ended December 31, 2005. The increase in total subscribers and the continued TDMA to CDMA conversion resulted in an increase of $3.7 million in handset, accessory and data content expense. As of December 31, 2006, 94% of our retail customer base resided on our CDMA network. The network build-out resulted in $6.1 million of additional expense. Advertising increased $1.3 million and we experienced an increase in regulatory charges and outsourced billing and provisioning costs of $1.6 million, directly associated with an increase in subscribers and end user revenue.

Internet. . Internet expense increased by $6.3 million, or 27.2% to $29.6 million for the year ended December 31, 2006, compared to $23.3 million for the year ended December 31, 2005. Consistent with the growth in DSL subscriber base, we saw an increase of $3.8 million in DSL cost of goods sold and $0.6 million in ISP access and circuit expenses. We also experienced a $2.1 million increase in labor expense driven by customer service related functions supporting our DSL products and the exercise of our option to assume ownership of a fiber-optic cable running from Fairbanks to Whittier via Anchorage.

Interexchange. Interexchange expenses decreased by $4.7 million, or 27.0% to $12.6 million for the year ended December 31, 2006, compared to $17.3 million for the year ended December 31, 2005. The decline is attributable to the receipt of $1.0 million in prior year access charge credits; a $0.4 million reduction in federal universal service surcharges; and a $4.7 million reduction in affiliate billing and collection expense, offset in part by an increase of $0.6 million in labor expenses; and a $1.0 million increase in interstate traffic usage charges associated with an increase in both rates and minutes of use.

Depreciation and amortization. Depreciation and amortization expense decreased $19.6 million, or 23.6%, for the year ended December 31, 2006 compared to the year ended December 31, 2005. The decrease is primarily attributable to certain asset classes reaching their maximum depreciable lives.

Interest expense. As a result of our debt restructuring activities, interest expense decreased by $4.8 million to $31.1 million for the year ended December 31, 2006 compared to $35.9 million for the year ended December 31, 2005.

Loss on extinguishment of debt. Loss on extinguishment of debt charges arose from various accretive debt restructuring transactions. Tender premiums were $6.4 million in 2006 compared to $18.3 million in 2005 and the write off of unamortized debt issuance costs and settlement of original issue discounts were $3.3 million in 2006 compared to $16.6 million in the same period last year.

Other. In 2006, we recognized a gain of $6.7 million following the liquidation of our stock holding in the Rural Telephone Bank (RTB), and a gain of $2.0 million arising from the settlement of our transaction to acquire the Crest Communications, LLC s Alaska terrestrial fiber network. See Note 21 Other Events for more information on these transactions.

Income Taxes

In 2006, we generated taxable income which was offset by net operating loss carry forwards. We did, however, incur an alternative minimum tax charge of $0.4 million.

Net income

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

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Operating Revenue

Operating revenue increased $24.1 million, or 8.0%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. Wireless, Internet and interexchange revenue increased compared to the corresponding period of 2004, while local telephone revenue decreased compared to the corresponding period of 2004.

Table of Contents

Local Telephone. Local telephone revenue, which consists of local network service, network access and deregulated and other revenue, decreased $8.3 million, or 4.0%, for year ended December 31, 2005 compared to the same period in 2004. The following table summarizes our consolidated local telephone revenue by category*:*

	Year Ended December 31,	
	2005	**2004**
	(in thousands)	
Local telephone revenue:		
Local network service	$ 86,482	$ 91,669
Network access revenue	92,379	97,536
Deregulated revenue and other	23,981	21,982
Total local telephone revenue	$ 202,842	$ 211,187

The following table summarizes our local telephone access lines:

	As of December 31,	
	2005	**2004**
Retail access lines	199,341	206,209
Wholesale access lines	13,966	16,590
Unbundled network elements loop (UNE-L)	50,875	64,589
Unbundled network elements platform (UNE-P)	6,703	6,365
Total local telephone access lines	270,885	293,753

Local network service revenue decreased $5.2 million or 5.7% for the year ended December 31, 2005, compared to the year ended December 31, 2004. Access lines in service decreased 7.8% to 270,885, primarily reflecting the net effect of access line losses offset by increases in UNE rates and improved line mix. In November 2004, we received a final order from the RCA with respect to UNE-L rates for Anchorage, retroactive to June 2004, increasing the UNE-L rate from $14.92 to $18.64, and on January 1, 2005, rates increased for UNE-P and UNE-L in Fairbanks and Juneau from $19.19 to $23.00 and from $16.71 to $18.00, respectively.

Network access revenue decreased $5.2 million, 5.3%, for the year ended December 31, 2005, compared to the same period in 2004. Network access revenue is based on a regulated return on rate base and recovery of allowable expenses associated with the origination and termination of toll calls for our retail and resale customers. The decrease was primarily attributable to higher than typical settlement adjustments to the prior year interstate access and universal service fund studies. We expect that network access revenue will decline as a component of local telephone revenue for the foreseeable future.

Deregulated and other revenue consists principally of billing and collection services, space and power rents, CPE, paystation revenue, regulated directory listing revenue, and other miscellaneous telephone revenue. Deregulated revenue increased $2.0 million, or 9.1% for the year ended December 31, 2005, compared to the year ended December 31, 2004, as the result of higher billing and collection revenue and an increase in net CPE sales.

Consistent with the U.S. telecommunications industry trend, we experienced a loss of local telephone access lines as customers migrated to broadband Internet services reducing demand for second lines, migrated to cable telephony, or replaced landline service with wireless service. During 2004, our primary competitor began deploying cable telephony and switching its UNE-L provisioned subscribers over to its own network.

Wireless. Wireless revenue increased $29.5 million, or 52.1%, to $86.2 million for the year ended December 31, 2005 compared to $56.7 million for the year ended December 31, 2004. This increase is due primarily to the following:

growth in subscribers year over year of 16.8% at December 31, 2005;

an increase in ARPU, of 23.8% to $54.45 for the year ended December 31, 2005, from $44.64 for the year ended December 31, 2004, primarily as a result of improved subscriber mix with a higher proportion of post paid retail subscribers, increased plan revenue, feature revenue, roaming revenue, regulatory surcharges and receipt of CETC funding on January 1, 2005 which added $7.33 to cellular ARPU in 2005;

higher gross customer adds, handset upgrades and accessory sales in the year ended December 31, 2005 resulting in $7.1 million of revenue compared to $5.1 million for the year ended December 31, 2004; and

higher revenue from non-ACS customers roaming on our network resulting in third-party roaming revenue increasing to $6.7 million from $1.6 million for the year ended December 31, 2005 and 2004, respectively.

Internet. Internet revenue increased $1.5 million, or 7.4%, for the year ended December 31, 2005 compared to the year ended December 31, 2004, primarily as a result of growth of DSL subscribers, increasing by 45.1% to 35,844 at December 31, 2005 from 24,711 at December 31, 2004, offset in part by a 23.8% reduction in dial-up subscribers to 17,401 at December 31, 2005.

Interexchange. Interexchange revenue increased $1.4 million, or 9.6%, for the year ended December 31, 2005, compared to the year ended December 31, 2004. Long distance subscribers increased 19.7% to 56,317 at December 31, 2005, from 47,050 at December 31, 2004 and annual minutes of use increased to 182.1 million for the year ended December 31, 2005, from 136.7 million for the year ended December 31, 2004. Minutes of use includes activity generated on our wireless network, with associated revenues recorded in our wireless segment.

Operating Expense

Operating expense increased $7.1 million, or 2.4%, to $299.7 million for the year ended December 31, 2005, from $292.6 million for the year ended December 31, 2004. Depreciation and amortization associated with the operation of each of our segments has been included in total depreciation and amortization.

Local Telephone. The components of local telephone expense are plant specific operations, plant non-specific operations, customer operations, corporate operations and property and other operating tax expense. Local telephone expense decreased $0.9 million to $127.0 million for the year ended December 31, 2005 from $127.9 million for the year ended December 31, 2004. The decrease in local telephone expense was the result of a number of factors. They include, a $2.3 million prior year charge related to the early extinguishment of an airplane operating lease and lower net charges for inventory write downs, consulting expense and legal reserves of $1.6 million, $1.5 million and $2.0 million, respectively. These decreases were partially offset by increases of $1.2 million in property taxes; $2.5 million in cost of goods sold, primarily related to our increase in CPE sales; $0.2 million in advertising; and $2.4 million in stock-based compensation costs associated with our adoption of SFAS No. 123(R) and restricted stock grants. In addition, we also implemented a contractual wage increase for our represented employees of approximately 2.8% on January 1, 2005.

Wireless. Wireless expense increased $11.5 million, or 30.3%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. The increase is driven by support costs for our 16.8% increase in subscribers and the continued rollout of our new CDMA network. This resulted in increases of $4.9 million in handset, accessory and data content expense, $0.7 million increase in circuit charges, and a $0.9 million increase in incremental roaming expense. We also increased our advertising and third party sales commissions by $1.2 million to promote our new network build out and premier product line outsourced our billing and provisioning system resulting in $1.1 million of additional expense, and recognized $0.3 million in stock-based compensation costs associated with our adoption of SFAS No. 123(R) and restricted stock grants. Additionally, in 2005, we adopted a new allocation methodology regarding certain interexchange expenses. We determined that this allocation would more appropriately match costs incurred to provide wireless end users with long distance service with revenues from those services. The result is a movement of expense from interexchange to wireless of approximately $3.4 million for the year ended December 31, 2005. The expense increases in 2005 were offset in part by prior year charges related to the termination of our airplane operating lease and reduction of consulting costs of $0.5 million and $0.2 million, respectively.

Internet. Internet expense decreased by $2.4 million, or 9.5% to $23.3 million for the year ended December 31, 2005, compared to $25.7 million for the year ended December 31, 2004. The decrease was due to a $1.1 million decline in internal labor which was primarily the result of severance expense in the first six months of 2004, $0.9 million in ISP access and expense reductions resulting from a decrease in DSL access loop costs and network grooming, $0.5 million decrease in IT software maintenance contract costs due to successful renegotiation of contracts, and a $0.7 million decrease in inventory write offs. Additionally, expenses declined $0.3 million due to the prior year charges related to the termination of our airplane operating lease and $0.2 million reduction in consulting expense. These decreases were partially offset by a $0.8 million increase in DSL cost of goods sold and $0.6 million in advertising related to growing our customer base.

Interexchange. Interexchange expenses decreased by $2.5 million, or 12.4% to $17.3 million for the year ended December 31, 2005, compared to $19.8 million for the year ended December 31, 2004. The decrease is primarily attributable to a $1.2 million decrease in legal consulting expenses associated with the infinite minutes class action lawsuit; a $0.1 million decrease related to the termination of our airplane operating lease; a $0.2 million reduction in consulting costs; and a $2.7 million decrease in cost of interexchange services due in part to the allocation of expenses to the wireless segment for wireless generated interexchange activity; offset in part by a $1.9 million increase in billing and collecting expense.

Depreciation and amortization. Depreciation and amortization expense increased $4.4 million, or 5.7%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. Approximately $3.0 million of the increase is due to additional depreciation associated with the build out of our new CDMA network and additional depreciation, due to lowering the expected remaining life of our TDMA network assets, and $1.2 million of the increase is due to asset additions related primarily to the upgrade in our back office customer support and provisioning system.

Interest expense. Interest expense decreased by $11.7 million to $35.9 million for the year ended December 31, 2005 compared to $47.6 million for the year ended December 31, 2004, driven by an $80.3 million reduction in gross debt and a reduction in our weighted average cost of debt to 7.1%.

Loss on extinguishment of debt. Loss on extinguishment of debt for the year ended December 31, 2005 of $34.9 million is attributable to our series of accretive debt restructuring activities undertaken during 2005 and is comprised of $18.3 million of tender premiums and $16.6 million for the write off of unamortized debt issuance costs and settlement of original issue discounts.

Income Taxes

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

Net loss

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

LIQUIDITY AND CAPITAL RESOURCES

Sources

We have satisfied our cash requirements for the year ended December 31, 2006 for operations, capital expenditures, debt service and dividend commitments primarily through internally generated funds, the sale of RTB stock, debt financing and our cash and investments on hand. For the year ended December 31, 2006, our net cash flows provided by operating activities were $90.7 million, inclusive of $8.9 million of cash payments for the settlement of redemption premiums and accrued interest on retired notes. Additionally in 2006, we received $7.7 million in cash from the redemption of our investment in Class C Rural Telephone Bank stock.

At December 31, 2006, we had approximately $12.9 million in net working capital, approximately $36.9 million in cash and cash equivalents, and $1.7 million in restricted cash. As of December 31, 2006, we had $45.0 million of remaining capacity under our revolving credit facility, representing 100% of available capacity.

In the first quarter of 2006, we engaged in certain transactions affecting our 2005 senior credit facility and our outstanding debt securities. We amended our 2005 credit facility, re-pricing the facility to London Inter-Bank Offered Rate (LIBOR) plus 1.75% from LIBOR plus 2.00% and increasing our term loan by $52.9 million. We used the $52.9 million of term loan proceeds together with cash on hand to buy down $60.9 million of our higher interest debt. We also entered into new interest swap agreements and with other swaps outstanding we effectively hedged LIBOR on our entire term loan.

As of December 31 2006, total long-term obligations outstanding, gross of original issue discount, were $438.3 million consisting primarily of the $472.9 million 2005 senior credit facility with a drawn term loan of $427.9 million and an un-drawn revolving credit facility of $45.0 million, and $4.0 million remaining aggregate principal amount outstanding of senior unsecured notes. The $427.9 million term loan under the 2005 senior credit facility was drawn on February 1,

Table of Contents

2005, July 15, 2005 and February 22, 2006 and generally bears interest at an annual rate of LIBOR plus 1.75%, with a term of seven years from the first closing date and no scheduled principal payments before maturity. The $45.0 million undrawn revolving credit facility, to the extent drawn in the future, will bear interest at an annual rate of LIBOR plus 2.00% and have a term of six years from the date of closing. To the extent the $45.0 million revolving credit facility under the 2005 senior credit facility remains undrawn; we will pay an annual commitment fee of 0.375% of the undrawn principal amount over its term. We also entered into floating-to-fixed interest rate swaps with total notional amounts of approximately $135.0 million, $85.0 million, $40.0 million, $115.0 million and $52.9 million which swap the floating interest rate on the entire term loan borrowings under the 2005 senior credit facility for a further three to five years at a fixed rate of 5.88%, 6.25%, 6.18%, 6.71% and 6.75%, per year, respectively, inclusive of the 1.75% premium over LIBOR. The swaps are accounted for as cash flow hedges.

The following summarizes our aggregate maturities of contractual obligations and commitments with quantifiable payment terms as of December 31, 2006:

	Total	2007	2008-2009	2010-2011	Thereafter
Long-term debt	$ 431,940	$	$	$ 4,040	$ 427,900
Interest on long-term debt	146,986	28,008	55,979	60,378	2,621
Capital leases	6,356	1,043	1,638	1,394	2,281
Operating leases	53,824	5,276	8,848	6,561	33,139
Unconditional purchase obligations	36,215	10,773	11,956	2,851	10,635
Total contractual cash obligations	$ 675,321	$ 45,100	$ 78,421	$ 75,224	$ 476,576

Uses

Our networks require the timely maintenance of plant and infrastructure. Our historical capital expenditures have been significant. The construction and geographic expansion of our wireless network has required significant capital. The implementation of our interexchange network and data services strategy is also capital intensive. Capital expenditures for the year ended December 31, 2006 were $60.2 million, of which $22.1 million, inclusive of an IRU with a fair value of $1.1 million that was funded as a part of a settlement negotiation, was expended on growth capital including our CDMA 1xRTT build out and the purchase of additional fiber-optic capacity. We intend to fund future capital expenditures with cash on hand, through internally generated cash flows, and if necessary, through borrowings under our revolving credit facility. At December 31, 2006, we had allocated $5.0 million of our current unrestricted cash balance of $36.9 million to fund additional network capacity in the areas of our CDMA 1xRTT and EV-DO build that are most heavily used by tourists who visit Alaska in the summer months and roam on our network.

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

On October 28, 2004, we announced the adoption of a dividend policy by our board of directors and declared our first quarterly dividend of $0.185 per share. Since adopting a dividend policy the board has increased the quarterly dividend rate twice; firstly in February 2005 when it was increased to $0.20 per share and secondly in February 2006 when it was increased to $0.215 per share. For the year ended December 31, 2006 dividend payments to our shareholders totaled $35.5 million.

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

Table of Contents

Outlook

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

- increasing demand for wireless voice and data services following the launch of our CDMA 1xRTT network;
- growth in demand for DSL, Internet access and data services due to higher business and consumer bandwidth needs; and
- increasing demand for private network services by government and business on a statewide basis on either a circuit switched or IP basis.

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

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

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

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

Item 7A. Quantitative and qualitative disclosures about market risk

As of December 31, 2006, we had outstanding senior unsecured notes and our 2005 senior credit facility. These on-balance sheet financial instruments, to the extent they provide for variable rates of interest, expose us to interest rate risk, with the primary interest rate risk exposure resulting from changes in LIBOR or the prime rate, which are used to determine the interest rates that are applicable to borrowings under our 2005 senior credit facility.

Table of Contents

The table below provides information about our sensitivity to market risk associated with fluctuations in interest rates as of December 31, 2006. To the extent that our financial instruments expose us to interest rate risk, they are presented within each market risk category in the table below. The table presents principal cash flows and related expected interest rates by year of maturity for our 2005 senior credit facility, senior unsecured notes, and capital leases and other long-term obligations outstanding at December 31, 2006. Weighted average variable rates for the 2005 senior credit facility are based on implied forward rates in the LIBOR yield curve as of December 31, 2006. Fair values as of December 31, 2006 included herein have been determined based on (i) quoted market prices for the 2005 senior secured credit facility; and (ii) quoted market prices for the senior unsecured notes. Our consolidated financial statements contain descriptions of the 2005 senior credit facility, senior unsecured notes and capital leases and other long-term obligations and should be read in conjunction with the table below.

($ in thousands)	2007	2008	2009	2010	2011	Thereafter	Total	Fair Value
Interest Bearing Liabilities								
2005 bank credit facility	$	$	$	$	$	$427,900	$427,900	$430,040
Weighted average interest rate (var)	7.03%	6.61%	6.62%	6.71%	6.78%	6.79%	6.75%	
Senior unsecured notes	$	$	$	$	$ 4,040	$	$ 4,040	$ 4,254
Average interest rate (fixed)	9.88%	9.88%	9.88%	9.88%	9.88%		9.88%	
Captial lease and other long-term	$1,043	$ 943	$ 695	$ 664	$ 730	$ 2,281	$ 6,356	$ 6,356
Average interest rate (fixed)	10.00%	10.22%	10.26%	10.37%	10.55%	11.34%	10.48%	
Interest Rate Derivatives								
Variable to Fixed Interest Rate Swap								
Notional Amount	$	$	$67,500	$	$	$	$ 67,500	$ 1,646
Fixed Rate Payable	4.13%	4.13%	4.13%				4.13%	
Weighted average Variance Rate Receivable	1.12%	0.75%	0.76%				0.87%	
Notional Amount	$	$	$67,500	$	$	$	$ 67,500	$ 1,655
Fixed Rate Payable	4.13%	4.13%	4.13%				4.13%	

Weighted average Variance Rate Receivable	1.12%	0.75%	0.76%				0.87%	
Notional Amount	$	$	$	$85,000	$	$	$ 85,000	$ 1,267
Fixed Rate Payable	4.50%	4.50%	4.50%	4.50%			4.50%	
Weighted average Variance Rate Receivable	0.74%	0.38%	0.37%	0.46%			0.49%	
Notional Amount	$	$	$	$	$ 40,000	$	$ 40,000	$ 976
Fixed Rate Payable	4.43%	4.43%	4.43%	4.43%	4.43%		4.43%	
Weighted average Variance Rate Receivable	0.82%	0.45%	0.44%	0.53%	0.61%		0.57%	
Notional Amount	$	$	$	$	$115,000	$	$115,000	$ 197
Fixed Rate Payable	4.96%	4.96%	4.96%	4.96%	4.96%		4.96%	
Weighted average Variance Rate Receivable (Payable)	0.28%	-0.08%	-0.09%	0.00%	0.07%		0.03%	
Notional Amount	$	$	$	$	$ 52,900	$	$ 52,900	$ 12
Fixed Rate Payable	5.00%	5.00%	5.00%	5.00%	5.00%		5.00%	
Weighted average Variance Rate Receivable (Payable)	0.25%	-0.12%	-0.13%	-0.04%	0.04%		0.00%	

In February 2006, we amended our 2005 senior credit facility, increasing the $375.0 million term loan under the facility by $52.9 million and re-priced the facility to LIBOR plus 1.75% from LIBOR plus 2.00%. The amendment and the re-price became effective as of February 23, 2006 and February 22, 2006 respectively; the amendment permits ACS Holdings to purchase the notes subject to its above noted tender offer for any and all of its currently outstanding 9 7/8 % Senior Notes due 2011.

In February 2006, the Company and ACS Holdings executed $115.0 million and $52.9 million notional amount floating-to-fixed interest rate swap agreements related to its $375.0 million term loan under its 2005 senior secured bank credit facility. The swaps effectively fix the LIBOR rate on $115.0 million and $52.9 million principal amount of senior secured bank debt at 6.71% and 6.75%, inclusive of a 1.75% premium over LIBOR, through December 2011. We had previously entered into interest rate swaps for a notional amount of $260.0 million, and this transaction fixes the rates on its entire term loan.

The table below provides information about our sensitivity to market risk associated with fluctuations in interest rates as of December 31, 2005. To the extent that our financial instruments expose us to interest rate risk, they are presented within each market risk category in the table below. The table presents principal cash flows and related expected interest rates by year of maturity for our 2005 senior credit facility, senior unsecured notes, and capital leases and other long-term obligations outstanding at December 31, 2005. Weighted average variable rates for the 2005 senior credit facility are based on implied forward rates in the LIBOR yield curve as of December 31, 2005. Fair values as of December 31, 2005 included herein have been determined based on (i) quoted market prices for the 2005 senior secured credit facility; and (ii) quoted market prices for the senior unsecured notes. Our consolidated financial statements contain descriptions of the 2005 senior credit facility, senior unsecured notes and capital leases and other long-term obligations and should be read in conjunction with the table below.

($ in thousands)	2006	2007	2008	2009	2010	Thereafter	Total	Fair Value
Interest Bearing Liabilities:								
2005 senior credit facility	$	$	$	$	$	$375,000	$375,000	$378,281
Weighted average interest rate (variable)	6.86%	6.86%	6.82%	6.91%	6.95%	6.32%	6.78%	
Senior unsecured notes	$	$	$	$	$	$ 64,978	$ 64,978	$ 69,221
Average interest rate (fixed)	9.88%	9.88%	9.88%	9.88%	9.88%	9.88%	9.88%	
Capital leases and other long-term	$ 970	$1,028	$ 926	$ 677	$ 643	$ 2,974	$ 7,218	$ 7,218
Average interest rate (fixed)	9.89%	9.99%	10.22%	10.26%	10.37%	11.10%	10.25%	
Interest Rate Derivative								
Variable to Fixed Interest Rate Swap								
Notional Amount	$	$	$	$67,500	$	$	$ 67,500	$ 1,570
Fixed Rate Payable	4.13%	4.13%	4.13%	4.13%			4.13%	
Weighted average Variance Rate Receivable	0.62%	0.62%	0.62%	0.69%			0.63%	

Notional Amount	$	$	$	$67,500	$	$	$ 67,500	$ 1,557
Fixed Rate Payable	4.13%	4.13%	4.13%	4.13%			4.13%	
Weighted average Variance Rate Receivable	0.62%	0.62%	0.62%	0.69%			0.63%	
Notional Amount	$	$	$	$	$85,000	$	$ 85,000	$ 882
Fixed Rate Payable	4.50%	4.50%	4.50%	4.50%	4.50%		4.50%	
Weighted average Variance Rate Receivable	0.25%	0.25%	0.25%	0.32%	0.45%		0.28%	
Notional Amount	$	$	$	$	$	$ 40,000	$ 40,000	$ 734
Fixed Rate Payable	4.43%	4.43%	4.43%	4.43%	4.43%	4.43%	4.43%	
Weighted average Variance Rate Receivable	0.33%	0.32%	0.32%	0.39%	0.46%	0.43%	0.37%	

Item 8. Financial Statements and Supplementary Data

Consolidated financial statements of Alaska Communications Systems Group, Inc. and Subsidiaries are submitted as a separate section of this Form 10-K. See Index to Consolidated Financial Statements and Schedule, which appears on page F-1 hereof.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Table of Contents

Item 9A. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2006, the end of the period covered by this Report.

Management s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework set forth in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework set forth in *Internal Control Integrated Framework,* our management concluded that our internal control over financial reporting was effective as of December 31, 2006. There have not been any changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company s fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting. Our management s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 and the Consolidated Financial Statements as of and for the year ended December 31, 2006 have has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their reports which are included herein.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Alaska Communications Systems Group, Inc.

We have audited management s assessment, included in the accompanying *Management s Report on Internal Control Over Financial Reporting,* that Alaska Communications Systems Group, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Alaska Communications Systems Group, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Alaska Communications Systems Group, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Alaska Communications Systems Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Alaska Communications Systems Group, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity (deficit) and comprehensive income (loss), and cash flows for each of the years in the two-year period ended December 31, 2006, and our report dated March 13, 2007 expressed an unqualified opinion on those consolidated financial statements.

(signed) KPMG LLP
Anchorage, Alaska
March 13, 2007

Table of Contents

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item is contained under the captions **Identification of Directors** and **Executive Officers** in our Proxy Statement for our 2007 Annual Meeting of Shareholders and are incorporated herein by reference.

Information on our audit committee financial experts is contained in our Proxy Statement for our 2007 Annual Meeting of Shareholders under the caption **Audit Committee Financial Expert,** and is incorporated herein by reference.

We have appointed a separately designated standing audit committee. The names of each of our audit committee members are contained in our Proxy Statement for our 2007 Annual Meeting of Shareholders under the caption **Identification of the Audit Committee,** and this information is incorporated herein by reference.

Information on the beneficial ownership reporting for our directors and executive officers is contained under the caption **Section 16(a) Beneficial Ownership Reporting Compliance** in our Proxy Statement for our 2007 Annual Meeting of Shareholders and is incorporated herein by reference.

Code of Ethics

We have adopted a code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer, or controller, and persons performing similar functions. We will provide to any person, free of charge, a copy of such code of ethics. The request must be submitted in writing to the Corporate Secretary, Alaska Communications Systems Group, Inc., 600 Telephone Avenue, Anchorage, Alaska 99503.

Item 11. Executive Compensation Summary Compensation Table

Information on compensation of our directors and executive officers is contained in our Proxy Statement for our 2007 Annual Meeting of Shareholders under the captions **Reg S-K, Item 402(b): Compensation Discussion and Analysis** , **Reg S-K, Item 402(c): Summary Compensation Table** , and **Reg S-K, Item 402(d)(2): Grants of Plan-Based Awards,** and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information with respect to security ownership of certain beneficial owners and management is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Table of Contents

Securities Authorized for Issuance under Equity Compensation Plans

As of December 31, 2006, the number of securities remaining available for future issuance under equity compensation plans includes 1,780,968 shares under the Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan, 158,665 shares under the ACS Group, Inc. 1999 Non-Employee Director Stock Compensation Plan, and 864,067 shares under the Alaska Communications Systems Group, Inc. 1999 Employee Stock Purchase Plan. All shares reserved under the non-qualified stock option agreement between Liane Pelletier and Alaska Communications Systems Group, Inc. have been awarded through stock options. See Note 13 Stock Incentive Plans , to the Alaska Communications Systems Group, Inc. Consolidated Financial Statements for further information on our equity compensation plans.

Equity compensation plans	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Approved by security holders:			
Stock options	894,314	$ 5.92	
Restricted stock	1,192,159	$	2,803,700
Not approved by security holders:			
Stock options	600,000	4.50	

Item 13. Certain Relationships and Related Transactions

Information with respect to such contractual relationships is incorporated herein by reference to the information in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Item 14. Principal Accountant Fees and Services

Information on our audit committee s pre-approval policy for audit services, and information on our principal accountant fees and services is contained in our Proxy Statement for our 2007 Annual Meeting of Shareholders under the caption **Audit Fees,** and is incorporated herein by reference.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) 1. *Financial Statements*

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

2. *Financial Statement Schedule*

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

(b) *Exhibits*

Exhibit No.	Description
2.1	Purchase Agreement, dated as of August 14, 1998, as amended, by and among ALEC Acquisition Sub Corp., CenturyTel of the Northwest, Inc. and CenturyTel Wireless, Inc. (1)
2.2	Asset Purchase Agreement, dated as of October 20, 1998, by and between Alaska Communications Systems, Inc. and the Municipality of Anchorage (1)
3.1	Amended and Restated Certificate of Incorporation of the Registrant (3)
3.2	Amended and Restated By-Laws of the Registrant (3)
4.1	Specimen of Common Stock Certificate (3)
4.2	Stockholders Agreement, dated as of May 14, 1999, by and among the Registrant and the Investors listed on the signature pages thereto (1)
4.3	First Amendment to Stockholders Agreement, dated as of July 6, 1999, by and among the Registrant and the Stockholders listed on the signature pages thereto (1)
4.4	Second Amendment to Stockholders Agreement, dated as of November 16, 1999 by and among the Registrant and the Stockholders listed on the signature pages thereto (3)
4.5	Indenture, dated as of May 14, 1999, by and between Alaska Communications Systems Holdings, Inc., the Guarantors (as defined therein) and IBJ Whitehall Bank & Trust Company (1)
4.6	Purchase Agreement, dated as of May 11, 1999, by and among Alaska Communications Systems Holdings, Inc., the Guarantors, Chase Securities Inc., CIBC World Markets Corp. and Credit Suisse First Boston Corporation (1)
4.7	Indenture, dated as of May 14, 1999, by and between the Registrant and The Bank of New York (1)
4.8	First Amendment, dated as of October 29, 1999, to Indenture listed as Exhibit No. 4.7 (2)
4.9	Form of Second Amendment dated as of November 17, 1999 to Indenture listed as Exhibit No. 4.7 (3)
4.10	

	Purchase Agreement, dated as of May 11, 1999, by and among the Registrant, DLJ Investment Partners, L.P., DLJ Investment Funding, Inc. and DLJ ESC II, L.P. (1)
4.11	Indenture, dated as of August 26, 2003, among Alaska Communications Systems Holdings, Inc., as Issuer, the Guarantors (as defined therein) and The Bank of New York, as trustee. (4)
4.12	Supplemental Indenture to Indenture listed as Exhibit No. 4.11, dated January 25, 2005, among the Company, Alaska Communications Systems Holdings, Inc., the guarantor s party thereto and The Bank of New York, as trustee. (7)
4.13	Supplemental Indenture to Indenture listed as Exhibit No. 4.5, dated January 25, 2005, among the Company, Alaska Communications Systems Holdings, Inc., the guarantors party thereto and The Bank of New York, as trustee. (7)
4.14	Supplemental indenture to Indenture listed as Exhibit No. 4.11, dated July 15, 2005, among the Registrant, Alaska Communications Systems Holdings, Inc., the guarantors party thereto and the Bank of New York, as trustee. (13)
4.15	Supplemental Indenture to Indenture listed as Exhibit No. 4.11, dated February 22, 2006, among the Company, Alaska Communications Systems Holdings, Inc., the guarantors party thereto and The Bank of New York, as trustee. (14)

Table of Contents

Exhibit No.	Description
10.1	Exchange and Registration Rights Agreement, dated as of May 14, 1999, by and among Alaska Communications Systems Holdings, Inc., the Guarantors, Chase Securities Inc., CIBC World Markets Corp. and Credit Suisse First Boston Corporation (1)
10.2	Exchange and Registration Rights Agreement, dated as of May 14, 1999, by and among the Registrant, DLJ Investment Partners, L.P., DLJ Investment Funding, Inc. and DLJ ESC II L.P. (1)
10.3	ALEC Holdings, Inc. 1999 Stock Incentive Plan (1)
10.4	Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan (3)
10.5	Alaska Communications Systems Group, Inc. 1999 Non-Employee Director Compensation Plan (3)
10.6	Alaska Communications Systems Group, Inc. 1999 Employee Stock Purchase Plan (3)
10.7	Exchange and Registration Rights Agreement, dated August 26, 2003, by and among Alaska Communications Systems Holdings, Inc., the Guarantors and J.P. Morgan Securities Inc. for itself and on behalf of CIBC World Markets Corp., Citigroup Global Markets Inc., Jefferies & Company, Inc. and Raymond James & Associates, Inc. (4)
10.8	Credit Agreement, dated August 26, 2003, among Alaska Communications Systems Group, Inc., Alaska Communications Systems Holdings, Inc., as the Borrower, the Lenders Party thereto and JPMorgan Chase Bank, as Administrative Agent and Collateral Agent, CIBC World Markets Corp., as Syndication Agent, and Citicorp North America, Inc., as Documentation Agent, and J.P. Morgan Securities Inc., as Arranger. (4)
10.9	Retirement Agreement, dated as of September 14, 2003, between Alaska Communications Systems Group, Inc. and Charles E. Robinson. (4)
10.10	Executive Employment Agreement, dated as of September 14, 2003, between Alaska Communications Systems Group, Inc. and Liane Pelletier. (4)
10.11	Settlement Agreement and Mutual Release, dated October 14, 2003, by and between the State of Alaska and Alaska Communications Systems Group, Inc. (4)
10.12	Executive Employment Agreement, dated as of October 17, 2003, between Alaska Communications Systems Group, Inc. and David C. Eisenberg. (5)
10.13	Executive Employment Agreement, dated as of January 23, 2004 between Alaska Communications Systems Group, Inc. and Sheldon Fisher. (6)
10.14	Executive Employment Agreement, dated as of February 18, 2004 between Alaska Communications Systems Group, Inc. and David Wilson. (6)
10.15	

	Letter Agreement, dated January 26, 2005, between Alaska Communications Systems Holdings, Inc. and Fox Paine & Company, LLC. (8)
10.16	Credit Agreement, dated February 1, 2005, among the Company, ACSH, the lenders named therein and Canadian Imperial Bank of Commerce, as Administrative Agent. (9)
10.17	Master Agreement, dated November 7, 1999, by and between Alaska Communications Systems Holdings, Inc. and the International Brotherhood of Electrical Workers, Local Union 1547. (10)
10.18	Letter Agreement, dated March 1, 2005, by and between Alaska Communications Systems Holdings, Inc. and the International Brotherhood of Electrical Workers, Local Union 1547. (10)
10.19	Consent and Agreement No. 1, dated July 15, 2005, among Alaska Communications Systems Group, Inc. , Alaska Communications Systems Holdings, Inc., the lenders party thereto and Canadian Imperial Bank of Commerce as Administrative Agent. (12)
10.20	Form of Restricted Stock Agreement between the Registrant and certain participants in the Registrant s 1999 Stock Incentive Plan. (13)
10.21	Consent and Agreement No. 2, dated February 22, 2006, among Alaska Communications Systems Group, Inc. , Alaska Communications Systems Holdings, Inc., the lenders party thereto and Canadian Imperial Bank of Commerce as Administrative Agent. (14)
10.22	2006 Officer Severance Program (15)
16.1	Letter of Deloitte & Touche LLP to the Commission dated March 17, 2005. (11)
21.1	Subsidiaries of the Registrant
23.1	Consent of KPMG LLP relating to the audited financial statements of Alaska Communications Systems Group, Inc.
23.2	Consent of Deloitte & Touche LLP relating to the audited financial statements of Alaska Communications Systems Group, Inc.
31.1	Certification of Liane Pelletier, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of David Wilson, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Table of Contents

Exhibit No.	Description
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.

(1) Filed as an exhibit to the Registrant s Registration Statement on Form S-4 file No. 333-82361 and incorporated by reference thereto.

(2) Filed as an exhibit to the Registrant s Form 8-K filed on November 5, 1999 and incorporated by reference thereto.

(3) Filed as an exhibit to the Registrant s Registration Statement on Form S-1/A file No. 333-888753 filed on November 17, 1999 and incorporated by reference thereto.

(4) Filed as an exhibit to Alaska Communications Systems Holdings, Inc. Registration Statement on

Form S-4 file No. 333-109927 filed on October 23, 2003 and incorporated by reference thereto.

(5) Filed as an exhibit to Alaska Communications Systems Holdings, Inc. Registration Statement on Form S-4/A file No. 333-109927 filed on January 21, 2004 and incorporated by reference thereto.

(6) Filed as an exhibit to the Registrant s Form 10-K filed on March 30, 2004 and incorporated by reference thereto.

(7) Filed as an exhibit to the Registrant s Form 8-K filed on January 26, 2005 and incorporated by reference thereto.

(8) Filed as an exhibit to the Registrant s Form 8-K filed on January 27, 2005 and incorporated by reference thereto.

(9)

Filed as an exhibit to the Registrant s Form 8-K filed on February 2, 2005 and incorporated by reference thereto.

(10) Filed as an exhibit to the Registrant s Form 8-K filed on March 7, 2005 and incorporated by reference thereto.

(11) Filed as an exhibit to the Registrant s Form 8-K filed on March 18, 2005 and incorporated by reference thereto.

(12) Filed as an exhibit to the Registrant s Form 8-K filed on July 21, 2005 and incorporated by reference thereto.

(13) Filed as an exhibit to the Registrant s Form 10-K filed on August 15, 2005 and incorporated herein by reference thereto.

(14) Filed as an exhibit to the Registrant s Form 8-K filed on February 27, 2006 and incorporated

herein by reference thereto.

(15) Filed as an exhibit to the Registrant s Form 8-K filed on July 17, 2006 and is incorporated by reference thereto.

Table of Contents

SIGNATURES

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

Date: March 13, 2007

Alaska Communications Systems Group, Inc.

By: /s/ Liane Pelletier

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

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

Signature	Title	Date
/s/ Liane Pelletier Liane Pelletier	Chief Executive Officer, Chairman of the Board and President (Principal Executive Officer)	March 09, 2007
/s/ David Wilson David Wilson	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 13, 2007
/s/ Annette M. Jacobs Annette M. Jacobs	Director	March 14, 2007
/s/ Brian Rogers Brian Rogers	Director	March 10, 2007
/s/ David A. Southwell David A. Southwell	Director	March 10, 2007
/s/ John M. Egan John M. Egan	Director	March 10, 2007
/s/ Patrick Pichette Patrick Pichette	Director	March 10, 2007
/s/ Gary R. Donahee Gary R. Donahee	Director	March 11, 2007

/s/ Edward J. Hayes, Jr.	Director	March 09, 2007
Edward J. Hayes, Jr.		

55

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

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Alaska Communications Systems Group, Inc.

We have audited the accompanying consolidated balance sheets of Alaska Communications Systems and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity (deficit) and comprehensive income (loss), and cash flows for each of the years in the two-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Alaska Communications Systems Group, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of its their operations and their cash flows for each of the years in the two-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Alaska Communications Systems Group, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2007 expressed an unqualified opinion on management s assessment of, and the effective operation of, internal control over financial reporting.

(signed) KPMG LLP
Anchorage, Alaska
March 13, 2007

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Alaska Communications Systems Group, Inc.

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

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

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

As discussed in Note 23, the accompanying 2004 consolidated financial statements have been restated.

Deloitte & Touche LLP
Portland, Oregon
March 7, 2005
(November 2, 2005 as to Note 23)

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Balance Sheets
December 31, 2006 and 2005
(In Thousands, Except Per Share Amounts)

	December 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 36,860	$ 28,877
Restricted cash	1,700	4,415
Short-term investments		10,525
Accounts receivable-trade, net of allowance of $7,434 and $6,206	39,801	41,080
Materials and supplies	7,977	7,885
Prepayments and other current assets	3,514	3,445
Total current assets	89,852	96,227
Property, plant and equipment	1,164,450	1,116,780
Less: accumulated depreciation	767,907	718,750
Property, plant and equipment, net	396,543	398,030
Goodwill	38,403	38,403
Intangible assets	21,604	21,688
Debt issuance cost	9,437	11,733
Deferred charges and other assets	6,482	10,332
Total assets	$ 562,321	$ 576,413
Liabilities and Stockholders Equity (Deficit)		
Current liabilities:		
Current portion of long-term obligations	$ 1,025	$ 683
Accounts payable affiliates	2,942	2,844
Accounts payable, accrued and other current liabilities	62,307	54,920
Advance billings and customer deposits	10,667	9,712
Total current liabilities	76,941	68,159
Long-term obligations, net of current portion	437,188	444,895
Other deferred credits and long-term liabilities	72,881	82,223
Total liabilities	587,010	595,277
Stockholders equity (deficit):		
	423	462

Common stock, $.01 par value; 145,000 authorized, 42,322 and 46,230 issued and 42,322 and 41,681 outstanding, respectively		
Treasury stock, 0 and 4,549 shares at cost		(18,443)
Additional paid in capital in excess of par	288,055	333,522
Accumulated deficit	(314,733)	(334,727)
Accumulated other comprehensive income	1,566	322
Total stockholders equity (deficit)	(24,689)	(18,864)
Commitments and contingencies		
Total liabilities and stockholders equity (deficit)	$ 562,321	$ 576,413

See Notes to Consolidated Financial Statements

F-3

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Operations
Years Ended December 31, 2006, 2005 and 2004
(In Thousands, Except Per Share Amounts)

	2006	2005	2004
Operating revenues:			
Local telephone	$ 192,058	$ 202,842	$ 211,187
Wireless	115,584	86,235	56,694
Internet	25,221	21,672	20,173
Interexchange	16,954	16,060	14,653
Total operating revenues	349,817	326,809	302,707
Operating expenses:			
Local telephone (exclusive of depreciation and amortization)	130,178	126,982	127,918
Wireless (exclusive of depreciation and amortization)	62,022	49,407	37,918
Internet (exclusive of depreciation and amortization)	29,625	23,298	25,739
Interexchange (exclusive of depreciation and amortization)	12,633	17,314	19,773
Depreciation and amortization	63,259	82,819	78,387
Loss (gain) on disposal of assets, net	1,105	(152)	2,854
Total operating expenses	298,822	299,668	292,589
Operating income	50,995	27,141	10,118
Other income and expense:			
Interest expense	(31,103)	(35,894)	(47,641)
Loss on extinguishment of debt	(9,650)	(34,882)	(3,423)
Interest income	1,835	2,253	1,633
Other	8,360	(253)	(200)
Total other income and expense	(30,558)	(68,776)	(49,631)
Income (loss) before income tax benefit	20,437	(41,635)	(39,513)
Income tax benefit (expense)	(443)		219
Net income (loss)	$ 19,994	$ (41,635)	$ (39,294)
Net income (loss) per share:			
Basic	$ 0.48	$ (1.04)	$ (1.33)
Diluted	$ 0.46	$ (1.04)	$ (1.33)

Weighted average shares outstanding			
Basic	42,045	40,185	29,592
Diluted	43,387	40,185	29,592

See Notes to Consolidated Financial Statements

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Stockholders Equity (Deficit)
and Comprehensive Income (Loss)
Years Ended December 31, 2006, 2005 and 2004
(In Thousands, Except Per Share Amounts)

	Common Stock	Shares Subject to Mandatory Redemption	Treasury Stock	Additional Paid in Capital in Excess of Par	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Stockholders Equity (Deficit)
Balance, January 1, 2004	$ 336	$ (1,198)	$ (17,118)	$ 278,181	$ (253,798)	$ (4,543)	$ 1,860
Components of comprehensive loss:							
Net loss					(39,294)		(39,294)
Minimum pension liability adjustment						12	12
Total comprehensive loss							(39,282)
Purchase of 267 shares subject to mandatory redemption		1,198	(1,262)				(64)
Purchase of 14 shares of common stock, $.01 par			(63)				(63)
Dividends declared				(5,694)			(5,694)
Issuance of 1,634 shares of common stock, pursuant to stock plans, $.01 par	16			9,785			9,801
Balance, December 31, 2004	352		(18,443)	282,272	(293,092)	(4,531)	(33,442)
Components of comprehensive loss:							
Net loss					(41,635)		(41,635)

Minimum pension liability adjustment					109	109
Interest rate swap marked to market					4,744	4,744
Total comprehensive loss						(36,782)
Dividends declared			(33,107)			(33,107)
Stock compensation costs			2,800			2,800
Cashless exercise of 128 option shares and related taxes			(757)			(757)
Issuance of 1,088 shares of common stock, pursuant to stock plans, $.01 par	10		6,107			6,117
Issuance of 9,897 shares of common stock, net of offering costs, $.01 par	100		76,207			76,307
Balance, December 31, 2005	462	(18,443)	333,522	(334,727)	322	(18,864)
Components of comprehensive income:						
Net income				19,994		19,994
Pension liability adjustment					234	234
Interest rate swap marked to market					1,010	1,010
Total comprehensive income						21,238
Dividends declared			(36,274)			(36,274)
Stock compensation costs			6,870			6,870

Cashless exercise of 123 stock plan shares and related taxes				(1,175)			(1,175)
Issuance of 641 shares of common stock stock, pursuant to stock plans, $.01 par	6			3,510			3,516
Retirement of 4,549 shares of stock held in treasury	(45)		18,443	(18,398)			
Balance, December 31, 2006	$ 423	$	$	$ 288,055	$ (314,733)	$ 1,566	$ (24,689)

See Notes to Consolidated Financial Statements

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Consolidated Statements of Cash Flows
Years Ended December 31, 2006, 2005 and 2004
(In Thousands)

	2006	2005	2004
Cash Flows from Operating Activities:			
Net income (loss)	$ 19,994	$ (41,635)	$ (39,294)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	63,259	82,819	78,387
Loss (gain) on disposal of assets	1,105	(152)	2,854
Gain on sale of long-term investments	(6,685)		
Amortization of debt issuance costs and original issue discount	5,180	18,760	6,088
Stock compensation costs	6,870	2,800	
Other non-cash expenses	234	109	12
Changes in components of assets and liabilities:			
Accounts receivable and other current assets	1,118	(2,650)	7,907
Accounts payable and other current liabilities	8,556	(7,977)	22
Deferred charges and other assets	3,882	3,760	1
Other deferred credits	(12,774)	502	3,048
Net cash provided by operating activities	90,739	56,336	59,025
Cash Flows from Investing Activities:			
Construction and capital expenditures	(60,216)	(58,422)	(51,422)
Purchase of short-term investments	(57,500)	(95,095)	(154,650)
Sale of short-term investments	68,025	119,770	162,672
Liquidation of long-term investments	7,663		
Placement of funds in restricted account		(700)	(1,055)
Release of funds from escrow	2,715	975	
Net cash used by investing activities	(39,313)	(33,472)	(44,455)
Cash Flows from Financing Activities:			
Repayments of long-term debt	(61,860)	(459,015)	(26,962)
Proceeds from the issuance of long-term debt	52,900	375,000	
Debt issuance costs	(1,349)	(11,307)	
Payment of cash dividend on common stock	(35,475)	(30,393)	
Issuance of common stock, net	2,341	88,885	9,801
Stock issuance costs		(7,817)	
Purchase of treasury stock			(1,325)
Net cash used by financing activities	(43,443)	(44,647)	(18,486)
Increase (decrease) in cash	7,983	(21,783)	(3,916)
Cash and cash equivalents at the beginning of the period	28,877	50,660	54,576

Cash and cash equivalents at the end of the period	$ 36,860	$ 28,877	$ 50,660
Supplemental Cash Flow Data:			
Interest paid, net of capitalized interest	$ 31,280	$ 39,474	$ 45,470
Income taxes paid, net of refund	264		876
(Increase) decrease in accounts payable for construction and capital expenditures	915	(5,975)	
Supplemental Noncash Transactions:			
Property acquired under capital leases and mortgages	$ 60	$	$
Dividend declared, but not paid	9,105	8,347	5,694

See Notes to Consolidated Financial Statements

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

1. DESCRIPTION OF COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying consolidated financial statements for the Company are as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004. They represent the consolidated financial position, results of operations and cash flows principally of ACS Group and the following wholly owned subsidiaries:

Alaska Communications Systems Holdings, Inc. (ACS Holdings)

ACS of Alaska, Inc. (ACSAK)

ACS of the Northland, Inc. (ACSN)

ACS of Fairbanks, Inc. (ACSF)

ACS of Anchorage, Inc. (ACSA)

ACS Wireless, Inc. (ACSW)

ACS Long Distance, Inc. (ACSLD)

ACS Internet, Inc. (ACSI)

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

Basis of Presentation

The consolidated financial statements include all majority-owned subsidiaries. In accordance with Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, intercompany revenue between local telephone and all other segments is not eliminated. All other significant intercompany balances have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Among the significant estimates affecting the financial statements are those related to the realizable value of accounts receivable, materials and supplies, long-lived assets, goodwill and intangible assets, income taxes and network access revenue reserves. Actual results may differ from those estimates.

Cash and Cash Equivalents

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

Restricted Cash

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

Short-term Investments

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

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Materials and Supplies

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

Property, Plant and Equipment

Telephone plant is stated substantially at original cost of construction. Telephone plant retired in the ordinary course of business, together with the cost of removal, less salvage, is charged to accumulated depreciation with no gain or loss recognized. Renewals and betterments of telephone plant are capitalized while repairs, as well as renewals of minor items, are charged to operating expense as incurred. The Company provides for depreciation of telephone plant on the straight-line method, using rates approved by regulatory authorities. The composite annualized rate of depreciation for all classes of telephone property, plant, and equipment was 4.6%, 5.8% and 6.1% for 2006, 2005 and 2004, respectively.

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

The Company is the lessee of equipment and buildings under capital leases expiring in various years through 2019. The assets and liabilities under capital leases are initially recorded at the lower of the present value of the minimum lease payments or the fair value of the assets at the inception of the lease. The assets are amortized over the lower of their related lease terms or the estimated productive lives. Amortization of assets under capital leases is included in depreciation and amortization expense for 2006, 2005 and 2004.

The Company is also the lessee of various land, building and personal property under operating lease agreements for which expense is recognized on a monthly basis.

Goodwill

Goodwill and indefinite-lived intangible assets are not amortized but are assessed for impairment on at least an annual basis. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values and are periodically reviewed for impairment. See Note 5, Goodwill and Other Intangible Assets .

Debt Issuance Costs

Underwriting, legal, accounting, printing and other fees and expenses associated with the issuance of the Company s senior credit facility, senior subordinated notes, senior unsecured notes and senior discount debentures are being amortized using the straight-line method which approximates the effective interest method, over the term of the debt. During 2005, the Company extinguished early its 2003 senior credit facility, senior unsecured notes and senior subordinated notes which resulted in a write off to expense of $14,784 of debt issuance costs. Debt issuance costs amortization included in loss on extinguishment of debt and interest expense for 2006, 2005 and 2004 was $3,645, $16,793 and $3,457, respectively.

Original Issue Discounts

Certain debt instruments of the Company have been issued below their face value, resulting in original issue discounts that are recorded net in long-term debt. These original issue discounts are amortized using the effective interest method. During 2005, the Company extinguished early its 2003 senior credit facility and repurchased a portion of its 2011 notes which resulted in a write off to expense of $1,557 of original issue discount. In 2006, the Company repurchased additional 2011 notes which resulted in a write off to expense of $1,479. Original issue discount amortization included in loss on extinguishment of debt and interest expense for 2006, 2005 and 2004 was $1,535, $2,000 and $2,631, respectively.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Preferred stock

The Company has 5,000, no par, shares authorized. Zero was issued or outstanding at December 31, 2006 and 2005.

Treasury Stock

The Company, with Board of Directors authorization, occasionally repurchases shares of its common stock. Since management intends to hold the treasury stock temporarily for later re-issuance, the cost method of accounting for treasury stock is used. The Company has repurchased a total of 4,749 shares and reissued 200 shares since 2002. On December 15, 2006, the Company s Board of Directors approved the retirement of 100% of the Company s treasury stock.

Revenue Recognition

Substantially all recurring service revenues are billed one month in advance and are deferred until earned. Non-recurring and usage sensitive revenues are billed in arrears and are recognized when earned. Certain of the Company s bundled products and services, primarily in wireless, have been determined to be revenue arrangements with multiple deliverables. Total consideration received in these arrangements is allocated and measured using units of accounting within the arrangement based on relative fair values. Wireless offerings include wireless phones and service contracts sold together in its Company-owned stores. The handset and activation fee revenue associated with these direct channel sales is recognized at the time the related wireless phone is sold and is classified as equipment sales. Monthly service revenue is recognized as services are rendered.

Additionally, the Company establishes estimated bad debt reserves against uncollectible revenues incurred during the period. The Company accounts for bad debt expense in accordance with SFAS No. 71 which prescribes that revenue be recognized net of bad debt expense.

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 Federal Communications Commission (FCC) within the interstate jurisdiction. Much of the interstate access revenue is initially recorded based on estimates. These estimates are derived from interim financial statements, available separations studies and the most recent information available about achieved rates of return. These estimates are subject to adjustment in future accounting periods as additional operational information becomes available. To the extent that disputes arise over revenue settlements, the Company s policy is to defer revenue collected until settlement methodologies are resolved and finalized. At December 31, 2006 and 2005, the Company had recorded liabilities of $21,448 and $19,197, respectively, related to its estimate of refundable access revenue. The increase in the reserve during the year ended December 31, 2006 of $2,250 was the net impact of increases to the reserve for the deferral of current period billed revenue, or cash receipts that are subject to dispute. This was offset, in part, by reductions to the reserve for refunds or revenue recognized following the settlement of prior period claims.

During 2005 and 2004, one customer accounted for 10% and 12%, respectively, of consolidated revenues and no customer accounted for more than 10% of consolidated revenue in 2006.

Income Taxes

The Company utilizes the asset-liability method of accounting for income taxes. Under the asset-liability method, deferred taxes reflect the temporary differences between the financial and tax bases of assets and liabilities using the enacted tax rates in effect in the years in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that management believes it is more likely than not that such deferred tax assets will not be realized.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 SFAS No. 71. This accounting recognizes the economic effects of rate regulation by recording cost and a return on investment as such amounts are recovered through rates authorized by regulatory authorities. Accordingly, 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 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 $65,724 and $52,565 as of December 31, 2006 and 2005, respectively, related to depreciation of the regulated telephone plant allocable to its intrastate and local jurisdictions. If the Company were not following SFAS No. 71, these costs would have been charged to expense as incurred. The Company also has a regulatory liability of $61,486 and $58,154 at December 31, 2006 and 2005, respectively, related to accumulated removal costs for its local telephone subsidiaries. If the Company were not following SFAS No. 71, it would have followed SFAS No. 143 for asset retirement obligations associated with its regulated telephone plant. Non-regulated revenues and costs incurred by the local telephone exchange operations and non-regulated operations of the Company are not accounted for under SFAS No. 71 principles. SFAS No. 71 also requires revenue generated between regulated and non-regulated group companies not be eliminated on consolidation; these revenues totaled $32,814, $32,219 and $27,927 for the years ended December 31, 2006, 2005 and 2004, respectively.

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

Non-Operating Expense

The Company periodically evaluates the fair value of its investments and other non-operating assets against their carrying value whenever market conditions indicate a change in that fair value. Any changes relating to declines in the fair value of non-operating assets are charged to non-operating expense under the caption Other in the Consolidated Statement of Operations.

Derivative Financial Instrument

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* and its corresponding amendments under SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* requires that an entity recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The accounting for changes in fair value of a derivative depends on the intended use of the derivative and its designation as a hedge. Derivatives that are not hedges must be adjusted to fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in fair value either offset the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or are recognized in other comprehensive income until the hedged transaction is recognized in earnings. The change in a derivative s fair value related to the ineffective portion of a hedge, if any, is immediately recognized in earnings. The Company does not enter into any derivative contracts for speculative purposes. On the date a derivative contract is entered into, the Company designates the derivative as either a fair value or cash flow hedge. The Company formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. If the Company determines that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company would discontinue hedge accounting prospectively and all amounts included in accumulated other comprehensive income would be immediately reclassified into earnings.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Dividend Policy

On October 28, 2004, the Company announced the adoption of a dividend policy by the board of directors and the board of directors declared its first quarterly dividend of $0.185 per share. On March 21, June 14, September 16, and November 29, 2005, the Company s board of directors declared quarterly cash dividends of $0.20 per share. On February 23, 2006 the board of directors approved an increase to the dividend of 7.5%. Dividends of $0.215 per share were declared February 22, June 15, September 15, and December 15, 2006. Dividends on the Company s common stock are not cumulative.

Adoption of SFAS No. 123(R), Share-Based Payment

As of July 1, 2005, the Company adopted 123(R), *Share-Based Payment,* using the modified retrospective method applied to prior interim periods in the year of initial adoption, which requires measurement of compensation cost from January 1, 2005, for all unvested stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The adoption of SFAS No. 123(R) resulted in additional stock based compensation expense of $539 being recorded for the twelve months ended December 31, 2005. The fair value of restricted stock and restricted stock units is determined based on the number of shares granted and the quoted price of our common stock on the date of grant, discounted for estimated dividend payments that do not accrue to the employee during the vesting period; and the fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with our valuation techniques previously utilized for options in footnote disclosures. Such value is recognized as expense over the service period, net of estimated forfeitures, using the straight line attribution method for stock-based payment grants from July 1, 2005 onwards and the graded vesting attribution method for legacy stock-based payment grants.

Prior to July 1, 2005, the Company accounted for stock-based awards under the intrinsic value method. The following table illustrates the effect on net income and earnings per share as if the fair value based method had been applied to all outstanding and unvested awards in periods prior to January 1, 2005:

	2004
Net loss:	
As reported	$ (39,294)
Deduct: Stock-based employee compensation expense	(1,938)
Pro forma net income (loss)	$ (41,232)
Net income (loss) per share basic and diluted:	
As reported	$ (1.33)
Pro forma	(1.39)

As the Company has a full valuation allowance against its deferred tax asset, adopting SFAS No. 123(R) had no impact on the net deferred tax asset balance.

Earnings Per Share

The Company uses the treasury stock method to calculate earnings per share.

Valuation Assumptions

The fair value for each stock option granted was estimated at the date of grant using a Black-Scholes option-pricing model. Expected volatilities are based on historical volatilities of our common stock; the expected life represents the weighted average period of time that options granted are expected to be outstanding giving consideration to vesting schedules and our historical exercise patterns; the dividend yield is based on dividend yield of the option strike price at grant date and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life. See Note 13, Stock Incentive Plans for additional information.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. This statement requires an employer to recognize in its statement of financial position the over-funded or under-funded status of a defined benefit postretirement plan measured as the difference between the fair value of a plan s assets and the benefit obligation. Employers must also recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period. The Statement was effective for the Company on December 31, 2006. Adoption of this standard resulted in a decrease in our pension assets of $4,034, a decrease to our pension liability of $3,296 and a decrease to other comprehensive income/loss of $738. See Note 14 Retirement Plans , for additional disclosure regarding the adoption of this standard.

In September 2006, the Securities and Exchange Commission published Staff Accounting Bulleting No. 108 *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. The interpretations in this Staff Accounting Bulleting are being issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice to build up improper amounts on the balance sheet. This guidance will apply to the first fiscal year ending after November 15, 2006, or December 31, 2006 for the Company. The adoption of SAB 108 did not have a material impact on the Company s financial position, results of operations or cash flows and no cumulative adjustment was required.

2. ACCOUNTS RECEIVABLE

Accounts receivable trade consists of the following at December 31, 2006 and 2005:

	2006	2005
Customers	$ 34,200	$ 33,202
Connecting companies	8,754	9,108
Other	4,281	4,976
	47,235	47,286
Less: allowance for doubtful accounts	7,434	6,206
Accounts receivable trade, net	$ 39,801	$ 41,080

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at December 31, 2006 and 2005:

	2006	2005
Land, buildings and support assets	$ 206,511	$ 203,717
Central office switching and transmission	316,204	306,901
Outside plant cable and wire facilities	515,345	499,115
Wireless switching and transmission systems	88,828	74,486
Other	3,640	3,609
Construction work in progress	33,922	28,952
	1,164,450	1,116,780
Less: accumulated depreciation and amortization	767,907	718,750

Property, plant and equipment, net	$ 396,543	$ 398,030

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

3. PROPERTY, PLANT AND EQUIPMENT (Continued)

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

	2006	2005
Land, buildings and support assets	$ 14,568	$ 14,535
Outside plant cable and wire facilities	2,115	2,115
	16,683	16,650
Less: accumulated depreciation and amortization	9,023	8,052
Property held under capital leases, net	$ 7,660	$ 8,598

Amortization of assets under capital leases included in depreciation expense in 2006, 2005 and 2004 was $1,053, $1,052 and $1,046, respectively.

The Company leases various land, buildings, right-of-ways and personal property under operating lease agreements. Rental expenses under operating leases for 2006, 2005 and 2004 were $4,725, $3,248 and $3,515, respectively.

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

2007	$ 5,276
2008	4,600
2009	4,248
2010	3,825
2011	2,736
Thereafter	33,139
	$ 53,824

4. ASSET RETIREMENT

In March 2005, the FASB issued FASB Interpretation (FIN) 47, *Accounting for Conditional Asset Retirement Obligations*. FIN 47 became effective for the Company on December 31, 2005, and requires 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 asset and liability of $61,486 and $58,154 at December 31, 2006 and 2005, 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 a retirement obligation of $1,171 and $836 and an associated asset of $731 and $501, at December 31, 2006 and 2005, respectively. These balances 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/depreciation over the life of the lease.

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

Balance, January 1, 2005	$ 726
Asset retirement obligation	51
Accretion expense	59
Settlement of lease obligations	
Balance, December 31, 2005	$ 836
Asset retirement obligation	239
Accretion expense	100
Settlement of lease obligations	(4)
Ending Balance, December 31, 2006	$ 1,171

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is tested for impairment at the reporting unit level at least annually utilizing a two-step methodology. The initial step requires the Company to determine the fair value of each reporting unit and compare it to the carrying value, including goodwill, of such unit. If the fair value exceeds the carrying value, no impairment loss would be recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount, if any, of the impairment is then measured in the second step. The second step of the goodwill impairment test compares the implied fair value of goodwill of the reporting unit with the carrying amount of that goodwill. The implied fair value of a reporting unit s goodwill is the excess of the fair value of a reporting unit over the amounts assigned to assets and liabilities. If the carrying value amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

The Company annually reassesses previously recognized intangible assets and has ceased amortization of indefinite-lived intangible assets. Wireless and PCS licenses have terms of 10 years, but are renewable indefinitely through a routine process involving a nominal fee. The Company has determined that no legal, regulatory, contractual, competitive, economic or other factors currently exist that limit the useful life of its wireless and PCS licenses. Therefore, the Company is not amortizing its wireless and PCS licenses based on the determination that these assets have indefinite lives. The Company evaluates its determination of indefinite useful lives for its wireless and PCS licenses each reporting period. Indefinite lived intangible assets are tested for impairment at least annually by comparing the fair value of the assets to their carrying amount.

The Company performs its annual impairment test as of the beginning of the fourth quarter or more frequently if events or changes in circumstance indicate possible impairment. The Company determines the fair value of each reporting unit for purposes of this test primarily by using a discounted cash flow valuation technique. Significant estimates used in the valuation include estimates of future cash flows, both future short-term and long-term growth rates, and estimated cost of capital for purposes of arriving at a discount factor. The annual impairment test conducted has resulted in no impairment charges being assessed. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their residual values and reviewed for impairment. The following table provides the gross carrying value and accumulated amortization for each major class of intangible asset as of December 31, 2006 based on the Company s reassessment of previously recognized intangible assets and their remaining amortization lives:

	Carrying Amount
Amortizable intangible assets:	
Customer lists	$ 915
Less: Accumulated amortization	(915)
Indefinite-lived intangible assets:	
Cellular licenses	18,193
PCS licenses	3,323
Domain names and trade names	88
	21,604

Total intangible assets	$ 21,604

For amortizable intangible assets the total intangible amortization expense for the years ended December 31, 2006, 2005 and 2004 was $91, $183 and $183, respectively.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

6. ACCOUNTS PAYABLE, ACCRUED AND OTHER CURRENT LIABILITIES

Accounts payable, accrued and other current liabilities consist of the following at December 31, 2006 and 2005:

	2006	2005
Accrued payroll, benefits, and related liabilities	$ 16,975	$ 13,731
Access revenue subject to refund	13,536	2,941
Accounts payable trade	11,503	15,993
Dividend payable	9,105	8,347
Other	11,188	13,908
	$ 62,307	$ 54,920

7. LONG-TERM OBLIGATIONS

Long-term obligations consist of the following at December 31, 2006 and 2005:

	2006	2005
2005 senior credit facility term loan	$ 427,900	$ 375,000
9 7/8% senior unsecured notes due 2011	4,040	64,978
Original issue discount - 9 7/8% senior unsecured notes due 2011	(83)	(1,618)
Capital leases and other long-term obligations	6,356	7,218
	438,213	445,578
Less: current portion	1,025	683
Long-term obligations, net of current portion	$ 437,188	$ 444,895

The aggregate maturities of long-term obligations for each of the five years and thereafter subsequent to December 31, 2006 are as follows:

2007	$ 1,043
2008	943
2009	695
2010	664
2011	4,770
Thereafter	430,181
	$ 438,296

2005 Senior Credit Facility

During 2005, the Company completed refinancing transactions whereby it entered into a new $380,000 senior secured credit facility, the 2005 senior credit facility, and used $335,000 of term loan borrowings under that facility, together with $76,307 in net proceeds of a simultaneous offering of the Company s common stock and cash on hand to repay in full and redeem the $198,000 of outstanding principal under the Company s 2003 senior credit facility, together with interest accrued thereon; repurchase $59,346 of outstanding principal of the Company s senior unsecured notes, together with tender premiums and interest accrued thereon; repurchase $147,500 of outstanding principal of the Company s senior subordinated notes, together with tender premiums and interest accrued thereon; and pay underwriters discounts and transaction fees and expenses associated with the equity offering and refinancing transactions. Accordingly, the Company recorded a loss on debt extinguishment of $26,204 and capitalized deferred financing costs of $10,637 related to the 2005 senior credit facility.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

7. LONG-TERM OBLIGATIONS (Continued)

The $427,900 term loan under the 2005 senior credit facility was first drawn on February 1, 2005, and generally bears interest at an annual rate of LIBOR plus 1.75%, with a term of seven years from the date of closing and no scheduled principal payments before maturity. The $45,000 un-drawn revolving credit facility, to the extent drawn in the future, will bear interest at an annual rate of LIBOR plus 2.00% and have a term of six years from the date of closing. To the extent the $45,000 revolving credit facility under the 2005 senior credit facility remains un-drawn, the Company will pay an annual commitment fee of 0.375% of the un-drawn principal amount over its term. The Company also entered into floating-to-fixed interest rate swaps with total notional amounts of $135,000, $85,000, $40,000, $115,000 and $52,900, respectively, which swap the floating interest rate on the entire term loan borrowings under the 2005 senior credit facility for remaining periods at December 31, 2006 which range from three to five years, at a fixed rate of 5.88%, 6.25%, 6.18%, 6.71% and 6.75% per year, respectively, inclusive of the 1.75% premium over LIBOR. The swaps are accounted for as cash flow hedges.

On July 15, 2005, the Company completed a refinancing transaction whereby it amended and entered into a new term loan under its 2005 senior credit facility with substantially the same terms, increasing the size of the facility to $420,000 and used the $40,000 of term loan and cash on hand to repurchase $41,326 of outstanding principal of its senior unsecured notes, together with redemption premiums, accrued interest and transaction fees and expenses associated with the refinancing transaction of $9,258. The Company recorded a loss on the early extinguishment of debt of $6,888 and capitalized deferred financing costs of $670 associated with this refinancing transaction.

In February 2006, the Company amended its 2005 senior credit facility, increasing the $375,000 term loan under the facility by $52,900 and re-priced the facility to LIBOR plus 1.75% from LIBOR plus 2.00%. The amendment and the re-price became effective as of February 23, 2006 and February 22, 2006, respectively. The amendment permits ACS Holdings to purchase any and all of its currently outstanding 9 7/8 % Senior Notes due 2011.

As of December 31, 2006 and 2005, the Company was in compliance with all of its debt covenants.

Senior Unsecured Notes

On August 26, 2003, the Company issued $182,000 in aggregate principal amount of 9 7/8% senior unsecured notes due 2011. Interest on the notes is payable semi-annually on February 15 and August 15. The notes mature on August 15, 2011, and are redeemable, in whole or in part, at the option of the Company, at any time on or after August 15, 2007, at 104.938% of the principal amount declining to 100% of the principal amount on or after August 15, 2010. In the first and third quarters of 2005 the Company repurchased $100,672 of the outstanding principal together with tender premiums and interest accrued. In the fourth quarter of 2005, the Company repurchased $12,000 of outstanding principal together with tender premiums and interest accrued. In January and February 2006, the Company s subsidiary, ACS Holdings, repurchased $8,039 principal amount of its existing 9 7/8% senior unsecured notes due 2011 (CUSIP No. 011679AF4) at a weighted average premium of 9.7% over the par value. The Company incurred an early extinguishment of debt charge of $1,206 in connection with this transaction, inclusive of $778 in cash premiums. In February 2006, ACS Holdings commenced a cash tender offer for any and all of the $56,939 aggregate principal amount of outstanding 9 7/8% senior unsecured notes due 2011 issued by ACS Holdings. In conjunction with the tender offer, ACS Holdings also solicited consents to adopt certain amendments to the indenture under which the senior notes were issued. The amendments to the senior notes indenture, among other things, eliminate substantially all of the restrictive covenants and eliminate most events of default, other than for failure to make payments of interest or principal. On February 23, 2006, the Company successfully repurchased $52,899 of the remaining $56,939 outstanding principal balance of these notes. The Company incurred an early extinguishment of debt charge of $8,423 in connection with this transaction, inclusive of $5,640 in cash premiums.

Capital leases and other long-term obligations

The Company has entered into various capital leases and other financing agreements totaling $6,356 and $7,218 with a weighted average interest rate of 10.00% and 10.25% at December 31, 2006 and 2005, respectively.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

8. OTHER DEFERRED CREDITS AND LONG-TERM LIABILITIES

Deferred credits and other long-term liabilities consist of the following at December 31, 2006 and 2005:

	2006	2005
Regulatory liabilities accumulated removal costs	$ 61,486	$ 58,154
Refundable access revenue	7,912	16,256
Other deferred credits	2,591	2,450
Pension obligations	892	5,363
	$ 72,881	$ 82,223

9. LOCAL TELEPHONE OPERATING REVENUE

Local telephone operating revenues consist of the following for the years ended December 31:

	2006	2005	2004
Local network service	$ 80,177	$ 86,482	$ 91,669
Network access revenue	90,894	92,379	97,536
Deregulated revenue and other	20,987	23,981	21,982
	$ 192,058	$ 202,842	$ 211,187

10. NON-OPERATING CHARGES

The Company periodically evaluates the fair value of its investments and other non-operating assets against their carrying value whenever market conditions indicate a change in that fair value. Any changes relating to declines in the fair value of non-operating assets are charged to non-operating expense under the caption Other in the Consolidated Statement of Operations. During 2003, the Company undertook an assessment of the net realizable value of its note receivable from Crest Communications LLC (Crest) and the option, as part of the note receivable, to purchase certain network assets from Crest as a result of changes in market and economic conditions (and a notice the Company received from the State of Alaska of termination of the TPA). As a result of the analysis, the Company recorded a charge of $15,924 representing the estimated decline in fair value of the note receivable from Crest. During 2005, the full balance of the note and accrued interest of $2,692 was fully reserved. In January 2006, the Company executed definitive agreements to assume ownership of strategic fiber optic cable network assets from Crest. As previously disclosed, pursuant to the Company s 2002 agreement with Crest, the Company was granted an option to exchange its $15,000 note for the strategic assets. See Note 21 Other Events for more information on this transaction.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

11. INCOME TAXES

For the years ended December 31, 2006, 2005 and 2004, a reconciliation of federal statutory tax at 34% and the recorded tax (expense)/benefit is as follows:

	2006	2005	2004
Computed federal income taxes at the 34% statutory rate	$ (6,948)	$ 14,156	$ 13,434
(Increase) reduction in tax resulting from:			
State income taxes (net federal benefit)	(1,194)	2,684	3,439
Excess compensation not allowed	(182)	(596)	
Other	(39)	(239)	(98)
Original issue discount interest			(185)
Recovery of previously paid income tax			219
Write-off of original issue discount			(713)
Prior year adjustments	181		
Stock based compensation	869	1,522	
Valuation allowance	6,870	(17,527)	(15,877)
Total income tax benefit (expense)	$ (443)	$	$ 219

The Company files a consolidated federal income tax return. The income tax provision for the years ended December 31, 2006, 2005 and 2004 comprised of the following charges:

	2006	2005	2004
Current:			
Federal income tax	$ (375)	$	$ 185
State income tax	(68)		34
Total current	(443)		219
Deferred:			
Federal income tax			
State income tax			
Total deferred			
Total income tax benefit (expense)	$ (443)	$	$ 219

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

11. INCOME TAXES (Continued)

The Company accounts for income taxes under the asset and liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets and liabilities at a combined effective rate of 40% (federal and state) as of December 31, 2006 and 2005 are as follows:

	2006	2005
Deferred tax liabilities long-term:		
Mark to market on interest rate swap	(2,301)	(1,897)
Other		(128)
Total long-term deferred tax liabilities	(2,301)	(2,025)
Deferred tax assets:		
Current:		
Accrued compensation	4,085	3,084
Accrued bad debts	2,934	2,483
Pension liability	1,675	1,769
Contingent liabilities	270	789
Self insurance accruals	597	
Other	237	282
Total current deferred tax assets	9,798	8,407
Long-term:		
Net operating loss carryforwards	57,431	68,502
Alternative minimum tax carryforward	1,320	876
Intangibles/Goodwill	26,753	33,063
Debt expense	1,708	1,365
Property, plant and equipment	23,083	16,109
Excess tax benefit from stock based compensation	2,595	862
Other	91	444
Total long-term deferred tax assets	112,981	121,221
Total deferred tax assets	122,779	129,628
Valuation allowance	(120,478)	(127,603)
Net deferred tax asset	$	$

In 2006, the Company recorded a decrease in its valuation allowance of $7,125, net of ($498) reflected in equity. In 2005, the Company recorded an increase in its valuation allowance of $15,395, net of ($1,940) related to the effect of changes in comprehensive income. Based on the weight of all available evidence, management believes it is more likely than not, that the deferred tax asset recorded may not be realized.

The Company files consolidated income tax returns with all if it subsidiaries for U.S. federal and with the State of Alaska. The Company is no longer subject to examination for years prior to 2003. The Company is not currently being audited, nor has it been notified of any pending audits. The Company is not aware of any controversial or unsupported positions taken on its tax returns that have not either been resolved in prior audits, by amending prior returns or by adjusting its Net Operating Loss (NOL) carry-forwards to rectify its filings. Income tax payable was $179 at December 31, 2006.

The Company is required to adopt the provision of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) effective for fiscal periods beginning after December 15, 2006. The Company does not anticipate the adoption of FIN 48 will have any material impact on its consolidated results of operations, cash flows, or financial position.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

11. INCOME TAXES (Continued)

In connection with the adoption of SFAS No. 123(R), the Company elected to calculate the pool of excess tax benefits under the modified retrospective method, but only to prior interim periods in the year of initial adoption. Tax benefits of $1,733 and $862 were generated in 2006 and 2005, respectively. The Company has recorded a full valuation allowance since it is more likely than not that the deferred tax assets may not be realized.

The Company has available at December 31, 2006, unused operating loss carry forwards of $143,576 that may be applied against future taxable income and that expire as shown below.

Year of Expiration	Internet Alaska s SRLY	Unused Operating Loss Carryforwards	Total Unused Operating Loss Carryforwards
2017	$ 27	$	$ 27
2018	328		328
2019	852		852
2020	2,631	6,275	8,906
2021		49,030	49,030
2022		17,983	17,983
2024		43,974	43,974
2025		22,476	22,476
	$ 3,838	$ 139,738	$ 143,576

Net Operating Loss (NOL) associated with the 2000 acquisition of Internet Alaska are limited by Separate Return Limitation Year (SRLY) rules and can only be used in years that both the Consolidated Group and Internet Alaska have taxable income.

Section 382 of the Internal Revenue Code of 1986, as amended, imposes an annual limit on the ability of a loss corporation that undergoes an ownership change to use its NOLs to reduce its tax liability. On December 7, 2005, ACS underwent an ownership change subject to the Section 382 loss limitation rules. ACS now has an estimated loss limitation of $19,054 per year for the usage of NOLs generated prior to December 7, 2005 (old loss) to offset future taxable income.

12. EARNINGS PER SHARE

Earnings per share are based on weighted average number of shares of common stock and dilutive potential common shares equivalents outstanding. Basic earnings per share includes no dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of an entity. The Company includes dilutive stock options based on the treasury stock method. Due to the Company s reported net losses, potential common share equivalents of 1,091 and zero, which consisted of options and restricted stock granted to employees and deferred shares granted to directors, were anti-dilutive for the years ended December 31, 2005 and 2004, respectively. The following table sets forth the computation of basic earnings per share for the years ending December 31, 2006, 2005 and 2004:

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

12. EARNINGS PER SHARE (Continued)

	2006	2005	2004
Numerator net income	$ 19,994	$ (41,635)	$ (39,294)
Denominator weighted average shares outstanding:			
Basic shares	42,045	40,185	29,592
Dilutive impact of options, restricted and deferred shares	1,342		
Dilutive shares	43,387	40,185	29,592
Earnings per share:			
Basic	$ 0.48	$ (1.04)	$ (1.33)
Diluted	$ 0.46	$ (1.04)	$ (1.33)

13. STOCK INCENTIVE PLANS

Under various plans, ACS Group, through the Compensation Committee of the Board of Directors, may grant stock options, restricted stock, stock appreciation rights and other awards to officers, employees and non-employee directors. At December 31, 2006, ACS Group has reserved a total of 10,060 (10.06 million) shares of authorized common stock for issuance under the plans. In general, options under the plans vest ratably over three, four or five years and the plans terminate in 10 years. After the plans terminate, all shares granted under the plan, prior to its termination, continue to vest under the terms of the grant when it was awarded.

Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan

ACS Group has reserved 7,160 shares under this plan, which was adopted by the Company in November 1999. At December 31, 2006, 8,551 equity instruments have been granted, 3,172 have been forfeited, 3,292 have been exercised, and 1,781 shares are available for grant under the plan.

In August 2005, the Company began granting restricted stock in lieu of stock options as the primary equity based incentive for executive and non-union represented employees. The time based restricted stock awards have vesting terms that can range from three to five years with equal annual vesting amounts. The performance based restricted stock awards cliff vest in five years and have accelerated vesting terms of one third per year if certain profitability and capital expenditure criteria are met. A long term incentive program (LTIP) also exists for executive management. LTIP awards also provide compensation from January 1, 2005 and cliff vest in five years with accelerated vesting in three years if cumulative three year profitability and capital expenditure criteria are met. In 2006, the Company implemented a program to grant performance based shares to union represented employees. Expense related to the union represented employee shares has been accrued and shares are expected to be granted in the first quarter of 2007. During 2006, the Company recognized compensation expense of $5,890 for all restricted stock awards, net of estimated forfeitures, over the applicable vesting period based on the market value at the date of grant, discounted for estimated dividend payments that do not accrue to the employee during the vesting period. Additionally, $778 was recognized as compensation expense for stock options.

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

This plan was also adopted by ACS Group in November 1999 and will terminate December 31, 2009. The Company has reserved 1,550 shares under this plan. At December 31, 2006, 864 shares are available for issuance and sale. All ACS Group employees and all of the employees of designated subsidiaries generally will be eligible to participate in the purchase plan, other than employees whose customary employment is 20 hours or less per week, is not more than five months in a calendar year, or who are ineligible to participate due to restrictions under the Internal Revenue Code.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

13. STOCK INCENTIVE PLANS (Continued)

A participant in the purchase plan may authorize regular salary deductions up to of a maximum of 15% and a minimum of 1% of base compensation. The fair market value of shares which may be purchased by any employee during any calendar year may not exceed $25. The amounts so deducted and contributed are applied to the purchase of shares of common stock at 85% of the lesser of the fair market value of such shares on the date of purchase or on the offering date for such offering period. The offering dates are January 1 and July 1 of each purchase plan year, and each offering period will consist of one six-month purchase period. The first offering period under the plan commenced on January 1, 2000. Shares are purchased on the open market or issued from authorized but un-issued shares on behalf of participating employees on the last business days of June and December for each purchase plan year and each such participant has the rights of a stockholder with respect to such shares. During the year ended December 31, 2006, approximately 24% of eligible employees elected to participate in the plan. During 2006, 2005 and 2004, 59, 56 and 73 shares were issued, respectively. In 2005, we recognized compensation expense of $133 upon adoption and in 2006 we recognized compensation expense of $202.

2003 Options for Officer Inducement Grant

During 2003, the Company s Board of Directors awarded 1,000 options as an inducement grant in hiring the Company s Chief Executive Officer. As of December 31, 2006, 400 options have been exercised/converted and 600 are currently outstanding.

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

The non-employee director stock compensation plan was adopted by ACS Group in November 1999. ACS Group has reserved 350 shares under this plan. At December 31, 2006, 191 shares have been awarded and 159 shares are available for grant under the plan. In 2006, 2005 and 2004, the plan required directors to receive not less than 50%, 50% and 25%, respectively, of their annual retainer in the form of ACS Group s stock. Directors were permitted to elect up to 100% of their annual retainer in the form of ACS Group s stock. Once a year, the Directors elect the method by which they receive their stock (issued or deferred). During the year ended December 31, 2006, 19 shares under the plan were awarded to directors, of which 8 were deferred until termination of service.

Fair Value Disclosures Prior to SFAS No. 123(R) Adoption

Stock-based compensation for the period prior to January 1, 2005, was determined using the intrinsic value method. See Note 1, Description of the Company and Significant Accounting Policies for the illustration of the effect on net income and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in periods prior to January 1, 2005.

SFAS No. 123(R), Share-Based Payment

Total compensation cost for share-based payments was $6,870 and $2,800 for the twelve months ended December 31, 2006 and 2005, respectively. The Company did not recognize a tax benefit from the stock compensation expense because the Company considers it more likely than not that the related deferred tax assets, which have been reduced by a full valuation allowance, will not be realized.

There were no options granted for the twelve months ended December 31, 2006 and seven options granted for the same period in 2005. There were 760 and 724 restricted stock grants for the twelve months ended December 31, 2006 and 2005, respectively. The following table describes the assumptions used for valuation of equity instruments awarded during the twelve months ended December 31, 2006, 2005 and 2004.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

13. STOCK INCENTIVE PLANS (Continued)

	2006	2005	2004
Stock Options:			
Risk free rate		4.21%	3.69%
Dividend yield		8.65%	3.09%
Expected volatility factor		40.17%	40.80%
Expected option life (years)		6.0	6.4
Expected forfeiture rate		2.00%	
Restricted stock grants:			
Risk free rate	5.25%	3.50%	
Dividend yield	5.81%	8.65%	
Expected forfeiture rate	2.16%	2.00%	

Options and Restricted Stock Outstanding

Stock Options

Proceeds from the exercise of stock options for the year ended December 31, 2006 were $2,217. The Company chose to remit $210 of these proceeds for payroll taxes in exchange for shares surrendered back to the Company. Information on outstanding options under the plan for the year ended December 31, 2006 is summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Life	Aggregate Intrinsic Value
Outstanding, January 1	1,981	$ 5.56		
Granted				
Exercised	(460)	6.05		
Canceled or expired	(27)	8.82		
Outstanding at December 31, 2006	1,494	5.35	6.61	$ 14,701
Exercisable at December 31, 2006	350	$ 6.95	6.47	2,886

Select information on equity instruments under the plan for the years ended December 31, 2006, 2005and 2004 follows:

	Twelve Months Ended December 31,		
	2006	2005	2004
Weighted-average grant-date fair value of equity instruments granted	$ 9.81	$ 8.63	$ 6.09
Total fair value of shares vested during the period	$2,762	$1,089	$ 962
Total intrinsic value of options exercised	$2,927	$5,076	$1,479

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

13. STOCK INCENTIVE PLANS (Continued)

Restricted Stock

Restricted stock grants outstanding, all of which are non-vested at December 31, 2006, are as follows:

	Number of Shares	Weighted Average Fair Value
Outstanding at January 1, 2006	724	$8.70
Granted	760	9.81
Vested	(195)	8.70
Canceled or expired	(97)	9.24
Outstanding at December 31, 2006	1,192	9.22

Unamortized stock-based payment and the weighted average expense period at December 31, 2006, are as follows:

	Unamortized Expense	Average Period to Expense (years)
Stock options	$ 594	0.9
Restricted stock	7,149	2.0
	$ 7,743	1.9

14. 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 s portion of the plan s pension cost for 2006, 2005 and 2004 was $11,892, $12,203 and $12,342, respectively.

The Company also provides a 401(k) retirement savings plan covering substantially all of its employees. The plan allows for discretionary contributions as determined by the Board of Directors, subject to Internal Revenue Code limitations. There was no matching contribution for 2006, 2005 or 2004.

The Company also has a separate defined benefit plan that covers certain employees previously employed by Century Telephone Enterprise, Inc. (CenturyTel Plan). This plan was transferred to the Company in connection with the acquisition of CenturyTel s Alaska Properties. Existing plan assets and liabilities of the CenturyTel Plan were transferred to the ACS Retirement Plan on September 1, 1999. Accrued benefits under the ACS Retirement Plan were determined in accordance with the provisions of the CenturyTel Plan. Upon completion of the transfer to the Company, covered employees ceased to accrue benefits under the plan. On November 1, 2000, the ACS Retirement Plan was amended to conform early retirement reduction factors and various other terms to those provided by the AEPP. As a result of this amendment, and under the prior provisions of FASB Statement No. 87, *Employers Accounting for Pensions,* prior service cost of $1,992 was recorded and will be amortized over the expected service life of the plan participants at the date of the amendment. The Company uses the traditional unit credit method for the determination of pension cost for financial reporting and funding purposes and complies with the funding requirements under the Employee Retirement Income Security Act of 1974 (ERISA). The plan is not adequately funded under ERISA at December 31, 2006, and management is considering a contribution of $300 to $700 in 2007 for the 2006 plan year. The Company uses a December 31 measurement date for the plan. The Company s applicable tax rate for 2006 and 2007 is 40%. All deferred tax assets have been evaluated and $120,478 valuation allowance has been recorded as of December 31, 2006.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

14. RETIREMENT PLANS (Continued)

In April 2005, ACS Group registered 250 shares of the Company s common stock under the *Alaska Communications Systems Retirement Plan* for the purpose of funding its retirement plans. On April 14, 2005, ACS Group funded the ACS Retirement Plan for the 2004 plan year with approximately $600 by transferring 62 shares in lieu of cash. During May and June 2005, the plan administrators sold the stock resulting in net proceeds after commissions of $581. In March and September 2006, the Company funded the ACS Retirement Plan for the 2005 plan year with additional contributions of $600 and $850, respectively.

In September 2006, the FASB issued FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*. This statement requires an employer to recognize in its statement of financial position the over-funded or under-funded status of a defined benefit postretirement plan measured as the difference between the fair value of a plan s assets and the benefit obligation. Employers must also recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period. The Statement was effective for the Company on December 31, 2006. The following is a calculation of the funded status of the ACS Retirement Plan using beginning and ending balances for 2006 and 2005 for the projected benefit obligation and the plan assets:

	2006	2005
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	$ 13,574	$ 13,327
Interest cost	762	757
Actuarial (gain) loss	(41)	105
Benefits paid	(691)	(615)
Projected benefit obligation at end of year	13,604	13,574
Change in plan assets:		
Fair value of plan assets at beginning of year	10,607	10,069
Actual return on plan assets	1,347	553
Employer contribution	1,450	600
Benefits paid	(691)	(615)
Fair value of plan assets at end of year	12,713	10,607
Funded status	$ (891)	$ (2,967)

The following table represents the net periodic pension expense for the ACS Retirement Plan for 2006, 2005 and 2004:

	2006	2005	2004
Interest cost	$ 762	$ 757	$ 748
Expected return on plan assets	(858)	(813)	(754)
Amortization of loss	444	474	502
Amortization of prior service cost	203	203	203

Net periodic pension expense	$ 551	$ 621	$ 699

In 2007, the Company expects amortization of prior service costs of $203 and amortization of net gains and losses of $308.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

14. RETIREMENT PLANS (Continued)

The following table reconciles the net amounts recognized in the balance sheet at December 31, 2006 and 2005. The presentation discloses the net effect of the implementation as a reduction in our pension liability now reflecting only the unfunded balance, an elimination of our pension assets and the movement of unfunded prior service costs to accumulated other comprehensive income/loss.

	2006	2005
Unrecognized prior service cost:		
Intangible asset	$	$ 942
Prepaid pension asset:		
Unrecognized prior service cost		942
Funded status		(2,967)
Unrecognized net loss		4,422
	$	$ 2,397
Additional pension liability:		
Funded status	(891)	(2,967)
Prepaid benefit cost		(2,397)
	$ (891)	$ (5,364)

	2006	2005	2004
Accumulated other comprehensive income/loss:			
Prior service cost	738		
Net loss	3,450	4,422	4,531
	$ 4,188	$ 4,422	$ 4,531

The assumptions used to account for the plan as of December 31, 2006 and 2005 are as follows:

	2006	2005
Discount rate for benefit obligation	5.89%	5.79%
Discount rate for pension expense	5.79%	5.75%
Expected long-term rate of return on assets	8.00%	8.00%
Rate of compensation increase	0.00%	0.00%

The discount rates were independently calculated by a consulting firm using a proprietary yield curve based on the top 30% of the universe of bonds included in the bond pool. The expected long-term rate of return on assets rate is the best estimate of future expected return for the asset pool, given the expected returns and allocation targets for the various classes of assets.

The plan s asset allocations at December 31, 2006 and 2005, by asset category are as follows:

Asset Category	2006	2005
Equity securities*	64%	70%
Debt securities*	30%	27%
Other/Cash	6%	3%
Total	100%	100%

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

The fundamental investment objective of the plan is to generate a consistent total investment return sufficient to pay plan benefits to retired employees, while minimizing the long term cost to the Company. The long-term (10 year and beyond) plan asset growth objective is to achieve a rate of return that exceeds the actuarial interest assumption after fees and expenses.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

14. RETIREMENT PLANS (Continued)

Because of the Company s long-term investment objectives, the Plan administrator is directed to resist being reactive to short-term capital market developments and to maintain an asset mix that is continuously rebalanced to adhere to the plan investment mix guidelines. The Plan s investment goal is to protect the assets longer term purchasing power. The Plan s assets are managed in a manner that emphasizes a higher exposure to equity markets versus other asset classes. It is expected that such a strategy will provide a higher probability of meeting the plan s actuarial rate of return assumption over time.

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

	Minimum	Maximum
Equity securities	40%	100%
Fixed income	20%	60%
Cash equivalents	0%	10%

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

2007	$ 713
2008	761
2009	807
2010	849
2011	871
2012-2016	4,744

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

The Company uses the projected unit credit method for the determination of post retirement health cost for financial reporting and funding purposes and complies with the funding requirements under ERISA. The Company made a contribution of $51 to the ACS Health Plan during 2004. No contribution was made for 2006, or 2005 and no contribution is expected in 2007. The Company uses a December 31 measurement date for the plan.

The following is a reconciliation of the beginning and ending balances for 2006 and 2005 for the projected benefit obligation and the plan assets for the ACS Health Plan:

	2006	2005
Change in accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation at beginning of the year	$ 171	$ 199
Interest cost	10	11
Actuarial (gain)/loss	(12)	(38)
Benefits paid	(1)	(1)

Accumulated postretirement benefit obligation at end of the year	$ 168	$ 171
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 205	$ 199
Actual return on plan assets	14	7
Benefits paid	(1)	(1)
Fair value of plan assets at end of year	$ 218	$ 205

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

14. RETIREMENT PLANS (Continued)

The following represents the net periodic postretirement benefit expense for the ACS Health Plan for 2006, 2005 and 2004:

	2006	2005	2004
Service cost	$	$	$ 6
Interest cost	10	11	16
Expected return on plan assets	(12)	(11)	(11)
Amortization of prior service cost			7
Curtailment loss			14
Net periodic postretirement benefit expense	$ (2)	$	$ 32

The following table represents the funded status of the ACS Health Plan at December 31, 2006 and 2005:

	2006	2005
Accumulated postretirement benefit obligation	$ (168)	$ (171)
Plan assets at fair value	218	205
Funded status	50	34
Unrecognized net (gain) or loss		(59)
Prepaid (accrued) benefit costs	$ 50	$ (25)

The Company expects to incur no net periodic costs associated with this plan in 2007. The actuarial assumptions used to account for the ACS Health Plan as of December 31, 2006 and 2005 is an assumed discount rate of 5.89% and 5.79% for projected benefit obligation and an assumed discount rate of 5.79% and 5.75% for plan expense, respectively, and an expected long term rate of return on plan assets of 6.00% and 6.00%, respectively. The discount rate is based on Moody s AA Corporate bonds. The expected long-term rate of return on assets is the best estimate of future expected return for the asset pool, given the expected returns and allocation targets for the various classes of assets.

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

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

Assumed health care cost trend rates have a significant effect on the amounts reported for the ACS Health Plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2006:

	+1%	-1%
Effect on total of service and interest cost components		(1)
Effect on accumulated postretirement benefit obligation	8	(10)

F-28

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

14. RETIREMENT PLANS (Continued)

The ACS Health Plan s asset allocations at December 31, 2006 and 2005, by asset category, are as follows:

Asset Category	2006	2005
Equity securities*	34%	33%
Debt securities*	59%	63%
Other/Cash	7%	4%
Total	100%	100%

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

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

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

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

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

2007	$16
2008	16
2009	16
2010	16
2011	16
2012-2016	58

15. BUSINESS SEGMENTS

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

Company evaluates the performance of its segments based on operating income (loss) and other quantitative factors related to the overall contribution of individual products and services to total Company performance.

The Company incurs interest expense, interest income, equity in earnings of investments and other operating and non-operating income and expense at the corporate level which are not allocated to the business segments, or evaluated by the chief operating decision maker in analyzing the performance of the business segments. These non-operating income and expense items are provided in the accompanying table under the caption All Other in order to assist the users of these financial statements in reconciling the operating results and total assets of the business segments to the consolidated financial statements. Common use assets are held at either the Company or ACS Holdings and are allocated to the business segments based on operating revenue. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

15. BUSINESS SEGMENTS (Continued)

The following table illustrates selected financial data for each segment as of and for the year ended December 31, 2006:

	Local Telephone	Wireless	Internet	Interexchange	All Other	Eliminations	Total
Operating revenues	$192,062	$115,627	$25,473	$25,317	$ 10,702	$(19,364)	$349,817
Depreciation and amortization	43,464	11,503	3,669	223	4,400		63,259
Operating income (loss)	9,810	38,034	(8,851)	7,010	4,992		50,995
Interest expense	(419)	(4)		(177)	(30,503)		(31,103)
Loss on extinguishment of debt					(9,650)		(9,650)
Interest income	1				1,834		1,835
Income tax (expense) benefit	(3,821)	(15,578)			18,956		(443)
Net income (loss)	5,571	22,451	(8,851)	6,833	(6,010)		19,994
Total assets	402,331	146,650	37,614	25,563	5,124	(54,961)	562,321
Capital expenditures	29,958	14,341	6,598	2,315	6,149		59,361

Operating revenue disclosed above includes inter-segment operating revenue of $52,178 of which $19,364 is eliminated. By segment, intercompany revenue balances are as follows: local telephone, $29,265 of which $19 is eliminated; wireless, $2,632 of which $43 is eliminated; Internet, $465 of which $252 is eliminated; interexchange, $9,129 of which $8,363 is eliminated; and all other, $10,687 of which $10,687 is eliminated. In accordance with SFAS No. 71, intercompany revenue between local telephone and all other segments is not eliminated above. Also eliminated above, is $54,961 of Internet intercompany payable balances which are recorded in the consolidated statements net of affiliate receivables.

The following table illustrates selected financial data for each segment as of and for the year ended December 31, 2005:

	Local Telephone	Wireless	Internet	Interexchange	All Other	Eliminations	Total
Operating revenues	$202,845	$ 86,279	$21,924	$21,434	$ 22,624	$(28,297)	$326,809
Depreciation and amortization	52,655	10,521	3,950	301	15,392		82,819
Operating income (loss)	3,209	23,577	(6,427)	284	6,498		27,141
Interest expense	(454)	(2)		(182)	(35,256)		(35,894)
Loss on extinguishment of debt					(34,882)		(34,882)
Interest income					2,253		2,253
Income tax (expense) benefit	(1,267)	(9,694)			10,961		

Net income (loss)	1,488	13,861	(6,427)	102	(50,659)		(41,635)
Total assets	423,815	127,777	35,226	21,847	11,668	(43,920)	576,413
Capital expenditures	30,173	12,148	15,296	455	6,325		64,397

Operating revenue disclosed above includes inter-segment operating revenue of $60,516 of which $28,297 is eliminated. By segment, intercompany revenue balances are as follows: local telephone, $28,782 of which $17 is eliminated; wireless, $2,524 of which $44 is eliminated; Internet, $453 of which $252 is eliminated; interexchange, $6,147 of which $5,374 is eliminated; and all other, $22,610 of which $22,610 is eliminated. In accordance with SFAS No. 71, intercompany revenue between local telephone and all other segments is not eliminated above. Also eliminated above, is $1,644 and $42,276 of wireless and Internet intercompany payable balances which are recorded in the consolidated statements net of affiliate receivables.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

15. BUSINESS SEGMENTS (Continued)

The following table illustrates selected financial data for each segment as of and for the year ended December 31, 2004:

	Local Telephone	Wireless	Internet	Interexchange	All Other	Eliminations	Total
Operating revenues	$211,169	$ 56,743	$ 20,280	$17,067	$ 23,097	$(25,649)	$302,707
Depreciation and amortization	52,368	7,480	3,925	430	14,184		78,387
Operating income (loss)	13,298	4,257	(10,304)	(3,402)	6,269		10,118
Interest expense	(311)	(13)		(187)	(47,130)		(47,641)
Loss on extinguishment of debt					(3,423)		(3,423)
Interest income					1,633		1,633
Income tax (expense) benefit	(5,254)	(1,854)			7,327		219
Net income (loss)	7,733	2,390	(10,304)	(3,589)	(35,524)		(39,294)
Total assets	482,062	120,053	27,628	22,695	16,423	(31,734)	637,127
Capital expenditures	26,426	13,935	4,654	5	6,402		51,422

Operating revenue disclosed above includes inter-segment operating revenue of $53,576 of which $25,649 is eliminated. By segment, intercompany revenue balances are as follows: local telephone, $25,612, of which $38 is eliminated; wireless, $2,046 of which $49 is eliminated; Internet, $210, of which $107 is eliminated; interexchange, $2,667 of which $2,414 is eliminated; and all other, $23,041 of which $23,041 is eliminated. In accordance with SFAS No. 71, intercompany revenue between local telephone and all other segments is not eliminated above. Also eliminated above, is $7,029 and $24,705 of wireless and Internet intercompany payable balances which are recorded in the consolidated statements net of affiliate receivables.

16. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Fox Paine & Company, LLC (Fox Paine), previously ACS Group s largest stockholder, was entitled to receive an annual management fee in the amount of 1% of the Company s net income before interest expense, interest income, income taxes, depreciation and amortization and equity in earnings (loss) of investments, calculated without regard to the fee pursuant to an agreement dated May 14, 1999. The annual management fee obligation to Fox Paine was terminated for periods beginning after December 31, 2004. A $2,700 transaction fee was paid to Fox Paine in February 2005 in connection with assistance rendered in structuring a stock offering and refinancing transaction that the Company completed during the first quarter of 2005. The transaction fee agreement was approved by the Company s board of directors. The management fee expense for the years ended December 31, 2005 and 2004 was $38 and $943, respectively.

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

During 2003, the Company spun off its Directory Business to ACS Media LLC and subsequently sold 99.9% of its interest in ACS Media LLC to the public through a Canadian income fund. As part of that transaction, the Company entered into several long-term contracts with ACS Media LLC, including a 50-year publishing agreement, a 50-year license agreement, and a 45-year non-compete agreement and a 10-year billing and collection agreement. At December 31, 2006, the Company had recorded in Accounts payable-affiliates, $2,942 due to ACS Media LLC under these contracts, primarily under the billing and collection agreement. In November 2006, ACS Media LLC was sold to new owners and taken private. At December 31, 2006, the Company had a right to minority representation of one manager of the permitted nine managers of ACS Media LLC as long as its contracts with ACS Media LLC were in effect. Leonard A. Steinberg, an officer of the Company, was a manager of ACS Media LLC at December 31, 2006. Subsequent to year end, the Company sold its remaining interest to the new owners and relinquished its right to be a manager of ACS Media LLC for cash of $162 and other valuable consideration.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

16. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS (Continued)

On September 14, 2003, the Company entered into an agreement with a retiring officer to reacquire 267 shares of the Company s stock owned by the officer in January 2004, at a purchase price per share equal to the highest average closing price of a share of the Company s stock during any 5-consecutive day trading period in January 2004. The officer delivered the shares to the Company in 2004, and the Company made repurchase payments totaling $1,262 to the officer in four equal quarterly installments commencing on March 31, 2004.

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

On November 29, 2005, the Company filed a preliminary prospectus supplement relating to a proposed offering of 10,000 shares of its common stock by Fox Paine. This offering was completed on December 7, 2005, after which Fox Paine beneficially owned 22.8% of our outstanding common stock. The Company incurred approximately $500 in transaction fees associated with the offering.

On March 10, 2006, the Company entered into an Underwriting Agreement, dated March 10, 2006, among the Company, certain affiliates of Fox Paine, LLC (Fox Paine), and RBC Capital Markets Corporation, as the underwriter, for the sale by Fox Paine of 9,549 shares of the Company s common stock, representing substantially all of Fox Paine s remaining holdings of the Company s common stock. The transaction was priced at $11.00 per share, and on March 15, 2006, the transaction closed. The Company did not receive any proceeds from the sale of these shares. The Company incurred $188 in transaction fees associated with the offering.

17. ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company has used derivative financial instruments to partially hedge variable interest transactions in the past and expects to do so in the future, when appropriate, for managing interest rate risk. To the extent that derivative financial instruments are outstanding as of a period end, the fair value of those instruments, represented by the estimated amount the Company would receive or pay to terminate the agreement, is reported on the balance sheet.

On February 1, 2005 and March 21, 2005, the Company entered into floating-to-fixed interest rate swaps with total notional amounts of $135,000, and $85,000, respectively, which swap the floating interest rate on a portion of the term loan borrowings under the 2005 senior credit facility for a five year term at a fixed rate of 6.13% and 6.50%, per year, respectively, inclusive of a 2.00% premium over LIBOR. On July 15, 2005, the Company entered into a six year $40,000 notional amount fixed to floating swap arrangement, effectively fixing the rate on the new term loan at 6.43% per year inclusive of a 2.00% premium over LIBOR. In February 2006, the Company renegotiated the 2005 senior secured credit facility from LIBOR plus 2.00% to LIBOR plus 1.75%, reducing the rate for the credit facility by 0.25%.

In February 2006, the Company and ACS Holdings executed $115,000 and $52,900 notional amount floating-to-fixed interest rate swap agreements related to its $375,000 term loan under its 2005 senior secured bank credit facility. The swaps effectively fix the LIBOR rate on $115,000 and $52,900 principal amount of senior secured bank debt at 6.71% and 6.75%, inclusive of a 1.75% premium over LIBOR, through December 2011.

On December 31, 2005 and 2006, all swaps were effective. The swaps have been marked to market with $5,754 recorded at December 31, 2006 as other comprehensive income on the Company s Consolidated Statement of Stockholders Equity (Deficit) and Comprehensive Income (Loss) with a corresponding asset recorded in Deferred charges on the Consolidated Balance Sheet.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

18. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values of cash and cash equivalents, accounts receivable and payable, and other short-term monetary assets and liabilities approximate carrying values due to their short-term nature. The fair value for the Company s 2006 senior credit facility, senior unsecured notes, capital leases and other long-term obligations were estimated based on quoted market prices. The Company held in-the-money interest rate swaps at December 31, 2006 that were marked to market. The carrying value of $5,754 and fair value are equal on that date.

The following table summarizes the Company s carrying values and fair values of the debt components of its financial instruments at December 31, 2006:

	Carrying Value	Fair Value
New senior credit facility term loan	$ 427,900	$ 430,040
9 7/8% senior unsecured notes due 2011	3,957	4,254
Capital leases and other long-term obligations	6,356	6,356
	$ 438,213	$ 440,650

The following table summarizes the Company s carrying values and fair values of the debt components of its financial instruments at December 31, 2005:

	Carrying Value	Fair Value
New senior credit facility term loan	$ 375,000	$ 378,281
9 7/8% senior unsecured notes due 2011	63,360	69,221
Capital leases and other long-term obligations	7,218	7,218
	$ 445,578	$ 454,720

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

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

Condensed Consolidating Balance Sheet
December 31, 2006

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 142	$ 36,718	$	$	$ 36,860
Restricted cash		1,700			1,700
Short term investments					
Accounts receivable-trade, net	17,557	22,244			39,801
Accounts receivable-affiliates	34,215	(44,940)	10,725		
Materials and supplies	7,977				7,977
Prepayments and other current assets	1,598	1,916			3,514
Total current assets	61,489	17,638	10,725		89,852
Investments	10	380,966	(35,381)	(345,585)	10
Property, plant and equipment	1,050,926	113,524			1,164,450
Less: accumulated depreciation and amortization	691,630	76,277			767,907
Property, plant and equipment, net	359,296	37,247			396,543
Goodwill				38,403	38,403
Intangible assets	21,604				21,604
Debt issuance costs		9,437			9,437
Deferred charges and other assets	397	6,075			6,472
Total assets	$ 442,796	$ 451,363	$ (24,656)	$ (307,182)	$ 562,321
Liabilities and Stockholders Equity					
Current liabilities:					

Current portion of long-term obligations	$ 627	$ 398	$	$	$ 1,025
Accounts payable-affiliates	2,845	97			2,942
Accounts payable, accrued and other current liabilities	9,872	38,866	33	13,536	62,307
Advance billings and customer deposits	10,665	2			10,667
Total current liabilities	24,009	39,363	33	13,536	76,941
Long-term obligations, net of current portion	3,046	434,142			437,188
Deferred income taxes	(12,348)	12,348			
Other deferred credits and long-term liabilities	85,526	891		(13,536)	72,881
Commitments and contingencies					
Stockholders equity:					
Common stock	2		423	(2)	423
Treasury stock					
Paid in capital in excess of par value	491,240	261,083	288,055	(752,323)	288,055
Retained earnings (accumulated deficit)	(148,679)	(298,030)	(314,733)	446,709	(314,733)
Accumulated other comprehensive loss		1,566	1,566	(1,566)	1,566
Total stockholders equity	342,563	(35,381)	(24,689)	(307,182)	(24,689)
Total liabilities and stockholders equity	$ 442,796	$ 451,363	$ (24,656)	$ (307,182)	$ 562,321

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

Condensed Consolidating Balance Sheet
December 31, 2005

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 132	$ 28,745	$	$	$ 28,877
Restricted cash		4,415			4,415
Short term investments		10,525			10,525
Accounts receivable-trade, net	18,391	22,689			41,080
Accounts receivable-affiliates	6,854	(8,372)	1,518		
Materials and supplies	7,885				7,885
Prepayments and other current assets	1,720	1,725			3,445
Total current assets	34,982	59,727	1,518		96,227
Investments	10	354,952	(20,346)	(334,606)	10
Property, plant and equipment	1,006,723	110,057			1,116,780
Less: accumulated depreciation and amortization	644,820	73,930			718,750
Property, plant and equipment, net	361,903	36,127			398,030
Goodwill				38,403	38,403
Intangible assets	21,688				21,688
Debt issuance costs		11,733			11,733
Deferred charges and other assets	552	9,770			10,322
Total assets	$ 419,135	$ 472,309	$ (18,828)	$ (296,203)	$ 576,413
Liabilities and Stockholders Equity					
Current liabilities:					
Current portion of long-term obligations	$ 596	$ 87	$	$	$ 683
Accounts payable-affiliates	2,773	71			2,844
	12,133	39,810	36	2,941	54,920

Accounts payable, accrued and other current liabilities					
Advance billings and customer deposits	9,706	6			9,712
Total current liabilities	25,208	39,974	36	2,941	68,159
Long-term obligations, net of current portion	3,561	441,334			444,895
Deferred income taxes	(5,984)	5,984			
Other deferred credits and long-term liabilities	79,801	5,363		(2,941)	82,223
Commitments and contingencies					
Stockholders equity:					
Common stock	2		462	(2)	462
Treasury stock			(18,443)		(18,443)
Paid in capital in excess of par value	491,240	297,356	333,522	(788,596)	333,522
Retained earnings (accumulated deficit)	(174,693)	(318,024)	(334,727)	492,717	(334,727)
Accumulated other comprehensive loss		322	322	(322)	322
Total stockholders equity	316,549	(20,346)	(18,864)	(296,203)	(18,864)
Total liabilities and stockholders equity	$ 419,135	$ 472,309	$ (18,828)	$ (296,203)	$ 576,413

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

Condensed Consolidating Statement of Operations
Year Ended December 31, 2006

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Operating revenue:					
Local telephone	$ 192,062	$ 10,702	$	$ (10,706)	$ 192,058
Wireless	115,627			(43)	115,584
Internet	25,473			(252)	25,221
Interexchange	25,317			(8,363)	16,954
Total operating revenue	358,479	10,702		(19,364)	349,817
Operating expense:					
Local telephone (exclusive of depreciation and amortization)	138,788	697		(9,307)	130,178
Wireless (exclusive of depreciation and amortization)	66,067			(4,045)	62,022
Internet (exclusive of depreciation and amortization)	30,186			(561)	29,625
Interexchange (exclusive of depreciation and amortization)	18,084			(5,451)	12,633
Depreciation and amortization	58,859	4,400			63,259
Gain on disposal of assets, net	492	613			1,105
Total operating expense	312,476	5,710		(19,364)	298,822
Operating income	46,003	4,992			50,995
Other income (expense):					
Interest expense	(600)	(30,503)			(31,103)
Loss on extinguishment of debt		(9,650)			(9,650)
Interest income	1	1,834			1,835
Other	16	34,358	19,994	(46,008)	8,360
Total other income (expense)	(583)	(3,961)	19,994	(46,008)	(30,558)
Income (loss) before income taxes	45,420	1,031	19,994	(46,008)	20,437
Income tax (expense) benefit	(19,406)	18,963			(443)

Net income (loss)	$	26,014	$	19,994	$	19,994	$	(46,008)	$	19,994

F-36

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

Condensed Consolidating Statement of Operations
Year Ended December 31, 2005

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Operating revenue:					
Local telephone	$ 202,845	$ 22,624	$	$ (22,627)	$ 202,842
Wireless	86,279			(44)	86,235
Internet	21,924			(252)	21,672
Interexchange	21,434			(5,374)	16,060
Total operating revenue	332,482	22,624		(28,297)	326,809
Operating expense:					
Local telephone (exclusive of depreciation and amortization)	146,980	734		(20,732)	126,982
Wireless (exclusive of depreciation and amortization)	52,665			(3,258)	49,407
Internet (exclusive of depreciation and amortization)	24,070			(772)	23,298
Interexchange (exclusive of depreciation and amortization)	20,849			(3,535)	17,314
Depreciation and amortization	67,427	15,392			82,819
Loss on disposal of assets, net	(152)				(152)
Total operating expense	311,839	16,126		(28,297)	299,668
Operating income	20,643	6,498			27,141
Other income (expense):					
Interest expense	(638)	(35,256)			(35,894)
Loss on extinguishment of debt		(34,882)			(34,882)
Interest income		2,253			2,253
Other	(3)	8,784	(41,635)	32,601	(253)
Total other income (expense)	(641)	(59,101)	(41,635)	32,601	(68,776)
Income (loss) before income taxes	20,002	(52,603)	(41,635)	32,601	(41,635)
Income tax (expense) benefit	(10,968)	10,968			

Net income (loss)	$	9,034	$	(41,635)	$	(41,635)	$	32,601	$	(41,635)

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

Condensed Consolidating Statement of Operations
Year Ended December 31, 2004

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Operating revenue:					
Local telephone	$ 211,169	$ 23,097	$	$ (23,079)	$ 211,187
Wireless	56,743			(49)	56,694
Internet	20,280			(107)	20,173
Interexchange	17,067			(2,414)	14,653
Total operating revenue	305,259	23,097		(25,649)	302,707
Operating expense:					
Local telephone (exclusive of depreciation and amortization)	145,507	2,585		(20,174)	127,918
Wireless (exclusive of depreciation and amortization)	42,179			(4,261)	37,918
Internet (exclusive of depreciation and amortization)	26,689			(950)	25,739
Interexchange (exclusive of depreciation and amortization)	20,037			(264)	19,773
Depreciation and amortization	64,203	14,184			78,387
Loss on disposal of assets, net	2,795	59			2,854
Total operating expense	301,410	16,828		(25,649)	292,589
Operating income	3,849	6,269			10,118
Other income (expense):					
Interest expense	(511)	(46,010)	(1,120)		(47,641)
Loss on extinguishment of debt			(3,423)		(3,423)
Interest income		1,633			1,633
Other	16	(2,482)	(34,751)	37,017	(200)
Total other income (expense)	(495)	(46,859)	(39,294)	37,017	(49,631)
Income (loss) before income taxes	3,354	(40,590)	(39,294)	37,017	(39,513)
Income tax (expense) benefit	(5,620)	5,839			219

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

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2006

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Net cash provided (used) by operating activities	$ 54,575	$ 30,168	$ 33,134	$ (27,138)	90,739
Cash Flows from Investing Activities:					
Construction and capital expenditures	(54,017)	(6,199)			(60,216)
Purchase of short-term investments		(57,500)			(57,500)
Sale of short-term investments		68,025			68,025
Liquidation of long-term investments		7,663			7,663
Release of funds from escrow		2,715			2,715
Net cash used by investing activities	(54,017)	14,704			(39,313)
Cash Flows from Financing Activities:					
Repayments of long-term debt	(548)	(61,312)			(61,860)
Proceeds from the issuance of long-term debt		52,900			52,900
Debt issuance costs		(1,349)			(1,349)
Payment of cash dividend on common stock			(35,475)		(35,475)
Dividends		(27,138)		27,138	
Issuance of common stock, net			2,341		2,341
Net cash provided (used) by financing activities	(548)	(36,899)	(33,134)	27,138	(43,443)
Decrease in cash and cash equivalents	10	7,973			7,983
Cash and cash equivalents, beginning of the period	132	28,745			28,877
	$ 142	$ 36,718	$	$	$ 36,860

Cash and cash equivalents, end of the period

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2005

	Combined Subsidiaries	ACS Holdings Parent Only	ACS Group Parent Only	Eliminations	ACS Group Consolidated
Net cash provided (used) by operating activities	$ 67,013	$ 2,727	$ 1,096	$ (14,500)	56,336
Cash Flows from Investing Activities:					
Construction and capital expenditures	(51,975)	(6,447)			(58,422)
Purchase of short-term investments		(95,095)			(95,095)
Proceeds from sale of short-term investments		119,770			119,770
Placement of funds in escrow		(700)			(700)
Release of funds from escrow		975			975
Net cash used by investing activities	(51,975)	18,503			(33,472)
Cash Flows from Financing Activities:					
Payments on long-term debt	(505)	(458,510)			(459,015)
Proceeds from issuance of long-term debt		375,000			375,000
Debt issuance costs		(11,307)			(11,307)
Payment of dividends on common stock			(30,393)		(30,393)
Dividends	(14,500)			14,500	
Capital contributions		51,771	(51,771)		
Issuance of common stock			88,885		88,885
Stock issuance costs			(7,817)		(7,817)
Net cash provided (used) by financing activities	(15,005)	(43,046)	(1,096)	14,500	(44,647)
Decrease in cash and cash equivalents	33	(21,816)			(21,783)
Cash and cash equivalents, beginning of the period	99	50,561			50,660
Cash and cash equivalents, end of the period	$ 132	$ 28,745	$	$	$ 28,877

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

19. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

Condensed Consolidating Statement of Cash Flows
Year Ended December 31, 2004

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

20. 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 $75 as of December 31, 2006 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.

The Company pledges substantially all property, assets and revenue as collateral on its outstanding debt instruments.

21. OTHER EVENTS

In January 2006, the Company executed definitive agreements to assume ownership of strategic fiber optic cable network assets from Crest Communications, LLC (Crest). The Company exercised its option in April 2005 to assume ownership of such assets. On April 17, 2006, the closing occurred whereby ACS assumed ownership of significant fiber optic transport facilities then owned by Crest in Alaska between Whittier and Anchorage, and between Anchorage and Fairbanks. The Company determined that there was no observable market price for the Crest assets. Accordingly, the Company used a discounted cash flow method based on existing revenue contracts; potential future business and internal savings the Company could generate by using the asset, together with the stand alone costs of operating the asset, and determined the fair value of the Crest assets was nominal. Consistent with the provisions of SFAS 114, *Accounting by Creditors for Impairment of Loans*, and the determination that the fair value was nominal, the amount recognized as income was the cash settlement of $1,979 upon taking possession of the asset.

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

21. OTHER EVENTS (Continued)

On April 11, 2006, the Company received $7,663 in cash from the liquidation of the Rural Telephone Bank (RTB) and the Company recognized a gain of $6,685 from the liquidation of its investment in Class C RTB stock, which had a carrying value of $978.

22. CONSOLIDATED QUARTERLY OPERATING INFORMATION (UNAUDITED)

	Quarterly Financial Data				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2006					
Operating revenues	$ 82,642	$85,071	$90,376	$91,728	$349,817
Operating income	8,904	12,186	16,024	13,881	50,995
Net income (loss)	(8,372)	13,506	8,720	6,140	19,994
Net income (loss) per share:					
Basic	(0.20)	0.32	0.21	0.15	0.48
Diluted	(0.20)	0.31	0.20	0.14	0.46
2005					
Operating revenues	$ 77,408	$81,225	$85,701	$82,475	$326,809
Operating income	6,991	8,183	7,229	4,738	27,141
Net loss	(28,530)	(312)	(7,863)	(4,930)	(41,635)
Net loss per share:					
Basic and diluted	(0.78)	(0.01)	(0.19)	(0.12)	(1.04)

23. PRIOR YEAR RESTATEMENT OF FINANCIAL STATEMENTS

Subsequent to the issuance of its financial statements for the year ended December 31, 2004, the Company determined, based upon supplemental accounting interpretation regarding the financial statement classification of auction-rate securities, the planned implementation of SFAS No. 123(R) and consultation with the audit committee that the following restatements should be made to its 2004 annual report:

Short-Term Investments

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

Cash Paid to Affiliate

The Company also restated its 2004 financial statements to reflect the cash payments of $1,262 made during the year ended December 31, 2004 related to the reacquisition of 267 shares of the Company s stock owned by a retired officer. The restatement resulted in an increase in cash flows from operations and an increase in cash flows used in financing activities.

Table of Contents

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.
Notes to Consolidated Financial Statements, Continued
Years Ended December 31, 2006, 2005, and 2004
(In Thousands, Except Per Share Amounts)

23. PRIOR YEAR RESTATEMENT OF FINANCIAL STATEMENTS (Continued)

Stock Incentive Plans

Subsequent to year end, the Company also reassessed its stock compensation plan models in anticipation of adopting SFAS No. 123(R), *Share-Based Payment,* in 2005. The primary cause of this restatement relate to the treatment of forfeitures and the period over which the compensation cost should be recorded. During the reassessment the Company also identified certain corrections to the stock option valuation model assumptions. The 2004 footnote disclosure in Note 1 was restated to correct these factors. As no stock-based compensation expense had yet been recorded by the Company, there was no change to the underlying financial statements other than Note 1.

On November 3, 2005, the Company filed a 2004 Form 10-K/A restating these items. The 2004 and 2003 balances presented within the 2005 Form 10-K are also reflective of the restatements.

Table of Contents

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

Description	Balance at Beginning of Period	Charged to costs and expenses	Charged to other accounts (1)	Deductions (2)	Balance at End of Period
2006 Allowance for doubtful accounts	$ 6,206	$ 5,121	$ (61)	$ (3,832)	$ 7,434
2005 Allowance for doubtful accounts	$ 4,869	$ 4,494	$ (26)	$ (3,131)	$ 6,206
2004 Allowance for doubtful accounts	$ 4,865	$ 2,922	$ 948	$ (3,866)	$ 4,869

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

(2) Represents credit losses, net of recovery.