

ALASKA COMMUNICATIONS SYSTEMS GROUP INC

Form 10-K

March 16, 2017

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

**(Mark One)**

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

**For the fiscal year ended December 31, 2016**

**or**

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

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

**Commission file number 000-28167**

**Alaska Communications Systems Group, Inc.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

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

**600 Telephone Avenue**

**Anchorage, Alaska**  
**(Address of principal executive offices)**

**99503-6091**  
**(Zip Code)**

**Registrant's telephone number, including area code: (907) 297-3000**

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

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>Common Stock, Par Value \$.01 per Share</b>	<b>The Nasdaq Stock Market LLC</b>
<b>Securities registered pursuant to Section 12(g) of the Act: None</b>	

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

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 No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

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, 2016 was approximately \$84 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 March 6, 2017 there were outstanding 51,952,009 shares of Common Stock, \$.01 par value, of the registrant.

### **Documents Incorporated by Reference**

Information required by Part II (Item 5) and Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference to portions of the registrant's definitive proxy statement for its 2017 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2016.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**ANNUAL REPORT ON FORM 10-K**

**FOR THE YEAR ENDED DECEMBER 31, 2016**

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**Cautionary Statement Regarding 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 Alaska Communications ) 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 forward-looking statements to be covered by the safe harbor provisions for forward-looking statements. 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 anticipates , believes , could , estimates , expects , in , may , plans , projects , seeks , should and variations of these words and similar expressions are intended to identify 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. Forward-looking statements may be contained in this Form 10-K under Item 1A, Risk Factors and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere. Actual future performance, outcomes, and results may differ materially from those expressed in forward-looking statements made by us as a result of a number of important factors. Examples of these factors include (without limitation):

governmental and public policy changes, including on-going changes in our revenues, or obligations we will assume to receive these revenues, resulting from regulatory actions affecting inter-carrier compensation, and on-going support for federal and state programs such as lifeline services to our customers and Carrier of Last Resort obligations

our size, because we are a smaller sized competitor in the markets we serve and we compete against large competitors with substantially greater resources

the Alaskan economy, which has been impacted by continued low crude oil prices. If sustained, they could have a significant impact on both the level of spending by the State of Alaska and the level of investment in resource development projects by major natural resource exploration and development companies in Alaska. Both outcomes may impact the economy in the markets we serve and impact our future financial performance

our ability to maintain our new cost structure as a more focused broadband and managed information technology ( IT ) services company following the sale and subsequent wind-down of our Wireless operations. Maintaining our cost reductions is key to generating cash flow from operating activities. If we fail to maintain these reductions, our financial condition will be impacted

the cost and availability of future financing, at the terms, and subject to the conditions necessary, to support our business and pursue growth opportunities; our debt could also have negative consequences for our business; for example, it could increase our vulnerability to general adverse economic and industry conditions, or limit our flexibility in planning for, or reacting to, changes in our business and the telecommunications industry; in addition, our ability to borrow funds in the future will depend in part on the satisfaction of the covenants in our credit facilities; if we are unable to satisfy the financial covenants contained in those agreements, or are unable to generate cash sufficient to make required debt payments, the lenders and other parties to those arrangements could accelerate the maturity of some or all of our outstanding indebtedness

disruptions or failures in the physical infrastructure or operating systems that support our businesses and customers, or cyber-attacks or security breaches of the physical infrastructure, operating systems or devices that our customers use to access our products and services

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our ability to successfully renegotiate the Company's Master Collective Bargaining Agreement with the International Brotherhood of Electrical Workers, Local 1547 ( "IBEW" ) that expired on December 31, 2016. As of the date of this report, negotiations for a new agreement are continuing and the parties will operate under the terms of the prior agreement until a new contract is in place. In the event of a work stoppage, we may be required to utilize cash on hand to support the funding of operations during the affected period

our ability to keep pace with rapid technological developments and changing standards in the telecommunications industry, including on-going capital expenditures needed to upgrade our network to industry competitive speeds, particularly in light of expected 5G deployments by mobile wireless carriers

our ability to continue to develop attractive, integrated products and services to evolving industry standards, and meet the pressure from competition to offer these services at lower prices

unanticipated damage to one or more of our undersea fiber optic cables resulting from construction or digging mishaps, fishing boats or other reasons

structural declines for voice and other legacy services within the telecommunications industry

a maintenance or other failure of our network or data centers

a failure of information technology systems

a third party claim that the Company is infringing upon their intellectual property, resulting in litigation or licensing expenses, or the loss of our ability to sell or support certain products

unanticipated costs required to fund our post-retirement benefit plans, or contingent liabilities associated with our participation in a multi-employer pension plan

the success or failure of any future acquisitions or other major transactions

geologic or other natural disturbances relevant to the location of our operations

the ability to attract, recruit, retain and develop the workforce necessary for implementing our business plan

the success of the Company's expansion into managed IT services, including the execution of such services for customers

the success of our joint venture with Quintillion Holdings, LLC to provide broadband solutions to the North Slope of Alaska

our internal control over financial reporting may not be effective, which could cause our financial reporting to be unreliable

our ability to meet or satisfy the terms and conditions of the 2017 Senior Credit Facility or to draw down funds under such facility or to meet its requirements

our ability to commence or complete the expected tender offer for our 6.25% Convertible Notes due 2018 or otherwise repurchase such notes, or repurchase shares of our Common Stock under our repurchase program

the matters described under Item 1A, 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 or our other reports not to occur as described. Except as otherwise required by applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Form 10K.

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.

## **PART I**

### **Item 1. Business**

#### **OVERVIEW**

Over the past five years, through a series of transactions and investments, we have evolved from a wireline and wireless telecom provider to a fiber broadband and managed IT services provider, focused

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primarily on business and wholesale customers in and out of Alaska. We also provide telecommunication services to consumers throughout the state. Our facilities based communications network extends throughout Alaska and connects to the contiguous states via our two diverse undersea fiber optic cable systems and our usage rights on a third undersea system. Our network is among the most expansive in Alaska and forms the foundation of service to our customers. We operate in a largely two-player terrestrial wireline market and we estimate our market share to be less than 25% statewide. However, our revenue performance relative to our largest competitor suggests that we are gaining market share in the markets we are serving. Our primary focus is to: (i) generate industry leading revenue growth through increasing broadband and managed IT service revenue with our business, wholesale and consumer customers, (ii) continuously improve our customer service, (iii) improve Adjusted EBITDA and Adjusted Free Cash Flow (both as defined in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations) performance through top line growth and margin management, and (iv) work with state and federal regulatory agencies to provide a stable and predictable regulatory environment for our business.

The sale of our wireless operations (the "Wireless Sale") in 2015 included the sale of both our one-third interest in the Alaska Wireless Network ("AWN") and our wireless customer contracts, but excluded our wifi-based services and the wireless backhaul contracts (which provide wireline broadband services to cellular towers) that we entered into after the formation of AWN. This transaction allowed us to exit a line of business facing increasing levels of competition and declining roaming revenues at an attractive price.

Our parent company, Alaska Communications Systems Group, Inc., was incorporated in 1998 under the laws of the state of Delaware. Our principal executive offices are located at 600 Telephone Avenue, Anchorage, Alaska 99503-6091. Our telephone number is (907) 297-3000 and our investor internet address is [www.alsk.com](http://www.alsk.com). Our customer internet address is [www.AlaskaCommunications.com](http://www.AlaskaCommunications.com).

## **Markets, Services and Products**

We operate our business under a single reportable segment. We manage our revenues based on the sale of services and products to the three wireline customer categories listed below. Prior to the Wireless Sale in the first quarter of 2015 we provided retail wireless services and generated certain revenue streams related to our ownership in AWN. Our focus is now exclusively on serving customers in the following areas:

### **Business and Wholesale (broadband, voice and managed IT services)**

### **Consumer (broadband and voice services)**

### **Regulatory (access charges, surcharges and federal and state support)**

The brand pillars supporting our products and services are reliability, customer service, trustworthiness and local presence. These are represented by the promise we make to our customers: "You can always expect to get the service as promised to you by an Alaska Communications representative. If you are not satisfied, we will work with you to provide a solution that meets your satisfaction."

Our services and products are described below. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, for a summary of service and product revenues generated by each of these customer groups.



## **Business and Wholesale**

Providing services to Business and Wholesale customers provides the majority of our revenues and is expected to continue being the primary driver of our growth over the next few years. Our business customers include large enterprises, government customers and small and medium business. We were the first Alaska-based carrier to be Carrier Ethernet 2.0 Certified and are currently the only Alaska-based carrier certified for multipoint-to-multipoint services. This certification means that we meet international standards for the quality of our broadband services. We also offer IP based voice including the largest SIP implementations in the state of Alaska, and are the first Microsoft Express Route provider in the state. We believe our network differentiates us in the markets we serve, because we prefer not to compete on price; but on the quality, reliability and the overall value of our solutions. Accordingly, we have significant capacity to sell into the network we operate and do so at what we believe are attractive incremental gross margins.

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Business services have experienced significant growth and we believe the incremental economics of business services are attractive. Given the demand from our customers for more bandwidth and services, we expect revenue growth from these customers to continue for the foreseeable future. We provide services such as voice and broadband, managed IT services including remote network monitoring and support, managed IT security and IT professional services, and long distance services primarily over our own terrestrial network. We are also positioning the Company to become the premier Cloud Enabler for business in the state of Alaska.

Our wholesale customers are primarily national and international telecommunications carriers who rely on us to provide connectivity for broadband and other needs to access their customers over our Alaskan network. The wholesale market is characterized by larger transactions that can create variability in our operating performance. We have a dedicated sales team that sells into this customer segment, and we expect wholesale revenue to grow for the foreseeable future.

## **Consumer**

We provide voice and broadband services to residential customers. Given that our primary competitor has extensive quad play capabilities (video, voice, wireless and broadband) we target how and where we offer products and services to this customer group in order to maintain our returns. Our focus is to leverage the capabilities of our existing network and sell customers our highest available bandwidth. Our primary competitive advantage is that we offer reliable internet service without data caps, while our competitor charges customers or throttles customers' speeds for exceeding given levels of data usage. Revenues from these customers began to stabilize in the second half of 2016 and we expect modest growth beginning in 2017.

## **Regulatory**

Regulatory revenue is generated from three primary sources: (i) Access charges, which include interstate and intrastate switched access and special access charges, and cellular access; (ii) Surcharges billed to the end user (pass-through and non-pass-through); and (iii) federal and state support. We provide voice and broadband origination and termination services to interstate and intrastate carriers. While we are compensated for these services, these revenue streams have been in decline and we expect them to continue to decline. In addition, as regulators have reformed traditional access charges, they have simultaneously implemented new end user surcharges that contribute to our revenue.

### *Access Charges*

Interstate and intrastate switched access are services based primarily on originating and terminating access minutes from other carriers. Special access is primarily access to dedicated circuits sold to wholesale customers, substantially all of which is generated from interstate services. Cellular access is the transport of tariffed local network services between switches for cellular companies based on individually negotiated contracts. For the years ended December 31, 2016, 2015 and 2014, access charges represented approximately 2.5%, 2.8% and 3.2%, respectively, of our total wireline revenue.

### *Surcharges*

We assess our customers for surcharges, typically on a monthly basis, as required by various state and federal regulatory agencies, and remit these surcharges to these agencies. These pass-through surcharges include Federal Universal Access and State Universal Access. These surcharges vary from year to year, and are primarily recognized as revenue, and the subsequent remittance to the state or federal agency as a cost of sale and service. The rates

imposed by the regulators continue to increase. However, because the charges are only assessed on a portion of our services, and that portion continues to decline, we expect these revenue streams to decline over time as the revenue base declines. Other non-pass-through surcharges are collected from our customers as authorized by the regulatory body. The amount charged is based on the type of line: single line business, multi-line business, consumer or lifeline. The rates are established based on federal or state orders. These charges are recorded as revenue and do not have a direct associated cost. Rather, they represent a revenue recovery mechanism established by the Federal Communications Commission ( FCC ) or the Regulatory Commission of Alaska. For the years ended December 31, 2016, 2015 and 2014, pass-through surcharges represented approximately 32%, 30% and 28%, respectively, of the total surcharge revenue billed to our end customers.

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*Federal and State Support*

We receive interstate and intrastate universal support funds and similar revenue streams structured by federal and state regulatory agencies that allow us to recover our cost of providing universal service in Alaska. For the year ending December 31, 2016 the Company recognized \$19.7 million in federal high cost universal service revenues to support our wireline operations in high cost areas. The FCC has released the CAF Phase II order specific to Alaska Communications which transitioned from CAF Phase I frozen support to CAF Phase II. Funding under the new program will generally require the Company to provide broadband service to unserved locations throughout the designated coverage area by the end of a specified build-out period, and meet interim milestone build-out obligations. In addition to federal high cost support, the Company is designated by the State of Alaska as a Carrier of Last Resort ( COLR ) in five of the six study areas. In addition to COLR, the Company receives Carrier Common Line ( CCL ) support. We do not receive COLR or CCL funding for the ACS of Anchorage study area. As a COLR we are required to provide services essential for retail and carrier-to-carrier telecommunication throughout the applicable coverage area. For the years ended December 31, 2016, 2015 and 2014, total federal and state support represented approximately 11%, 12% and 13%, respectively, of total wireline revenue.

**Wireless and AWN Related Revenue**

Prior to the Wireless Sale in the first quarter of 2015, we provided wireless voice and broadband services, and other value-added wireless products and services, such as wireless devices, across Alaska with roaming coverage available in the contiguous states, Hawaii and Canada by utilizing the AWN network.

Because our network provides access to the retail marketplace, and as a result of the cost of providing service to high cost areas, we generated Competitive Eligible Telecommunications Carrier ( CETC ) revenues established by either state or federal regulatory agencies. As part of the AWN Formation, we agreed to pay a service charge to AWN for an amount equal to our CETC Revenue, and therefore CETC Revenue had no impact on our net income (loss) or Adjusted EBITDA calculations.

Prior to the AWN Formation, we also provided backhaul services to other wireless carriers. Backhaul services are broadband connections between a wireless carrier's cell site, their central office switch and connectivity to the Internet. Upon the AWN Formation, all existing backhaul contracts were transferred to AWN. However, we were not excluded from providing backhaul services in the future, and now compete for these services. We have since added wireless backhaul contracts, and expect to continue to vigorously compete for and grow these revenues.

Following the Wireless Sale, we were required to provide transition services to General Communication, Inc. ( GCI ), which required us to continue to maintain certain aspects of our retail wireless operations, such as the operation of our retail stores, maintaining wireless retail customer support functions in our contact center and providing certain supply chain management, billing and collection and treasury management functions. These transition services were completed on April 17, 2015.

**Network and Technology**

There are two extensive facilities based wireline telecommunications networks in Alaska. We operate one of these networks and GCI operates the other. We provide switched and dedicated voice and broadband services as well as a host of other value added services such as network hosting, managed IT services and long distance services. We continuously upgrade our network to provide higher levels of performance, higher bandwidth speeds, increased levels of security and additional value added services to our customers. Our networks are monitored for performance around the clock in redundant monitoring centers to provide a high level of reliability and performance. Our fiber network,

which serves as the backbone of our network, is extensive within Alaska's urban areas and connects our largest markets, including Anchorage, Fairbanks and Juneau with each other and the contiguous states. It offers us the opportunity to provide our customers with a high level of network reliability and speed for voice and broadband applications. We also own and operate one of the most expansive Internet Protocol ( IP ) networks in Alaska using multi-protocol label switching ( MPLS ), Metro Ethernet technology and Virtual Private LAN Service ( VPLS ). Our MPLS network provides the long-haul framework for our Metro Ethernet service, which we market to businesses and government customers. Metro Ethernet offers our

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customers scalable, high-speed broadband and customized IT products and services, as well as Internet connectivity. VPLS allows customers to connect their dispersed locations with the ease of use and control offered by Metro Ethernet and the quality and reliability of our MPLS services. We are one of the few Metro Ethernet Forum certified carriers in the nation, providing the highest degree of assurance to our customers regarding the quality of our network and services.

We also own and operate an undersea fiber optic cable system that connects our Alaskan network to our facilities in Oregon and Washington. These facilities provide the most survivable service to and from Alaska, with key monitoring and disaster recovery capabilities for our customers. In 2015 we acquired certain capacity on another provider's network providing us with diverse connectivity into Juneau, thus eliminating what was previously a single point of failure. We also have usage rights along another undersea fiber network connected to the lower-48.

Our network in Oregon and Washington includes terrestrial transport components linking Nedonna Beach, Oregon to a Network Operations Control Center in Hillsboro, Oregon and collocation facilities in Portland, Oregon and Seattle, Washington. In addition, AKORN®, one of our undersea fiber optic cable systems, connects our Alaska network from Homer, Alaska to our facilities in Florence, Oregon along a diverse path within Alaska, the Pacific Northwest and undersea in the Pacific Ocean. Northstar, our other undersea fiber optic system, has cable landing facilities in Whittier, Juneau, and Valdez, Alaska, and Nedonna Beach, Oregon. Our AKORN® and Northstar systems provide a total of 6,000 miles of submarine fiber. Together, these fiber optic cables provide extensive bandwidth as well as survivability protection designed to serve our own, as well as our most demanding customers' critical communications requirements. Through our landing stations in Oregon, we also provide an at-the-ready landing point for other large fiber optic cables, and their operators, connecting the U.S. to networks in Asia and other parts of the world.

In April 2015, we entered into an agreement to purchase a terrestrial fiber network on the North Slope of Alaska. This network allows us to provide broadband solutions to the oil and gas sector in a market that previously had no competition, and continue to advance our sales of managed IT services. Also in April 2015, the Company entered into a joint venture agreement with Quintillion Holdings, LLC ( "Quintillion" ) for the purpose of expanding the fiber optic network and making the network available to other telecom carriers. The joint venture may also participate in and facilitate other capital and service initiatives in the telecom industry. During 2015 and 2016 we focused on beginning to make the network operational in order to meet our service level standards.

Additionally, our joint venture partner, Quintillion, is investing in a global submarine network with contemplated landing stations in several northwest Alaska communities, including a terrestrial route from the North Slope to Fairbanks. Opportunities to acquire capacity on this system should allow for meaningful extensions to our network reach in Alaska.

## **Competition**

Management estimates the Alaska wireline telecom and IT services market to be approximately \$1.6 billion. This market is comprised of the IT services market of approximately \$830 million, the broadband market of approximately \$630 million and the voice market of approximately \$140 million. Management estimates that over 85% of this market opportunity is from the business and wholesale customer segment.

We expect to experience significant growth in managed IT services over time by providing these services to our broadband customers. We believe the competition for managed IT services is fragmented.

We face strong competition in our markets from larger competitors with substantial resources. For traditional voice and broadband services, we compete with GCI and AT&T on a statewide basis, and smaller providers such as

Matanuska Telephone Association, Inc. on a more localized basis.

As the largest facilities based operator in Alaska, GCI is the dominant statewide provider of broadband, voice, wireless and video services. In the markets where we compete with GCI (broadband and voice), GCI has approximately 60% of the market share in the consumer segments and 51% market share in the business segments. GCI continues to expand its voice and data network, often taking advantage of subsidized government programs which create a monopoly for services in certain markets. AT&T s

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primary focus is to be the provider of voice and broadband services to its nation-wide customers. AT&T tends to use its existing broadband network to serve these customers or it leases capacity from GCI or Alaska Communications to augment its existing network.

Prior to the Wireless Sale, we competed with AT&T, GCI, with Verizon for retail wireless services. AT&T's strong market position in Alaska is in wireless, and we estimated that AT&T had over 50% market share. The wireless market experienced significant disruption over the past several years, primarily related to Verizon's entry into the Alaska market in 2013 and reforms in wireless CETC Revenue for wireless carriers in Alaska.

Overall competitive dynamics are significant, and our operating performance is impacted accordingly. For more information associated with the risks of our competitive environment see Item 1A, Risk Factors.

## **Marketing**

Our marketing strategy relies on our history of understanding the Alaskan customer. We increasingly tailor our products and services based on understanding our customers' needs, location, and type of service they desire. For business customers we bundle our products and provide value added managed IT services using our local service delivery model and highly reliable network. For consumer customers we focus on offering one flat rate price and no data usage caps for internet services, differentiating ourselves from GCI who charges for excess data usage or throttles bandwidth.

## **Sales and Distribution Channels**

Our sales strategy combines primarily direct and some indirect distribution channels to retain current customers and drive sales growth. Our focus in 2017 is to continue leveraging our direct sales channels serving Business and Wholesale customers, and our web and contact center channels for consumer customers for continued sustained performance. In 2015 and 2016, we focused on improved customer service and moved more consumer transactions to the web. This trend is expected to continue in 2017.

## **Customer Base**

We generate our revenue through a diverse statewide customer base and there is no reliance on a single customer or small group of customers. Business and wholesale customers are our primary focus and they comprised 60.3% of our total revenue in 2016.

## **Seasonality**

We believe our revenue is impacted by seasonal factors. This is due to Alaska's northern latitude and the resulting wide swing in available daylight and weather conditions between summer and winter months. These conditions, unique to Alaska, affect business, tourism and telecom use patterns in the state. Our spending patterns are also impacted by seasonality as we incur more capital spending and operating spending during the summer and early fall periods of the year, reflecting the heightened economic activity from the summer months and our own construction activities during this time period.

## **Employees**

As of December 31, 2016, we employed 629 regular full-time employees, 9 regular part-time employees and 4 temporary employees. Approximately 56% of our employees are represented by the IBEW. Our Master Collective



Bargaining Agreement ( CBA ) with the IBEW, governs the terms and conditions of employment for all IBEW represented employees working for us in the state of Alaska and expired on December 31, 2016. As of the date of this report, negotiations for a new agreement are continuing, and the parties will operate under the terms of the prior agreement until a new contract is in place. Management considers employee relations to be generally good.

## **Regulation**

While a substantial amount of our revenues are derived from non-regulated or non-common carrier services, we continue to generate revenue from services that are regulated. 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.

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### **Overview**

Some of the telecommunications services we provide are subject to extensive federal, state and local regulation. These regulations govern, in part, our rates and the way we conduct our business, including the requirement to offer telecommunications services pursuant to nondiscriminatory rates, terms, and conditions, the obligation to comply with E-911 rules, the Communications Assistance for Law Enforcement Act ( CALEA ), the obligation to safeguard the confidentiality of customer proprietary network information ( CPNI ), as well as our obligation to maintain specialized records and file reports with the FCC and state regulators. These requirements are subject to frequent change. Compliance is costly, and limits our ability to respond to some of the demands of our increasingly competitive service markets.

We generate revenue from these regulated services through regulated charges to our retail customers, access and other charges to other carriers, and federal and state universal service support mechanisms for telecommunications and broadband services. These revenues are recorded throughout our customer categories. Prior to the sale of our interest in AWN to GCI in the first quarter of 2015, we remitted an amount equal to the federal universal service support associated with our wireless business to AWN, and that support therefore, had no direct impact to our net income (loss), cash flow from operating activities or Adjusted EBITDA. After the sale, we ceased to receive that support, but continue to receive federal and state universal service support associated with our wireline operations.

At the federal level, the FCC generally exercises jurisdiction over some of the services regulated common carriers provide that originate or terminate interstate or international communications and related facilities.

The Regulatory Commission of Alaska ( RCA ) generally exercises jurisdiction over services and facilities used to provide, originate or terminate communications between points in Alaska.

In this section, Regulation , we refer to our local exchange carrier ( LEC ) subsidiaries individually as follows:

ACS of Anchorage, LLC ( ACSA );

ACS of Alaska, LLC ( ACSAK );

ACS of Fairbanks, LLC ( ACSF ); and

ACS of the Northland, LLC ( ACSN ).

### **Federal Regulation**

We must comply with the Communications Act of 1934, as amended (the Communications Act ) and regulations promulgated thereunder, which require, among other things, that we offer regulated interstate services upon request at just, reasonable and non-discriminatory rates and terms. The Communications Act also requires us to offer competing carriers interconnection and non-discriminatory access to certain facilities and services designated as essential for local competition, and permits the FCC to deregulate us as markets become more competitive. Under the Communications Act we are eligible for support revenues to help defray the cost of providing services to rural, high cost areas, low-income consumers, schools and libraries, and rural health care providers. Many of these regulations

recently have been modified by the FCC and others are the subject of on-going FCC rule-makings that are expected to result in further changes; in both cases, the changes are intended to expand the support mechanisms to include broadband Internet access services, and promote additional deployment of equipment, facilities, and systems necessary to support such services.

### ***Rate Regulation***

Our LEC subsidiaries are regulated common carriers offering local voice and a limited set of data services and are subject to a mixture of competitive market regulations and rate of return regulations for intrastate services we offer in Alaska, and price-cap rate regulation for interstate services regulated by the FCC. Because they face competition, our LEC subsidiaries may not be able to charge their maximum permitted rates under price cap regulation or realize their allowed intrastate rate of return even where they are rate-of-return regulated. A broader range of data and information services are offered by our unregulated affiliates or as unregulated services by our regulated companies.

In establishing their costs of regulated telecommunications services, our LEC subsidiaries determine their

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aggregate costs and place them within an FCC-prescribed Uniform System of Accounts, then allocate those costs between regulated and non-regulated services, then separate the regulated portion of these costs between the state and federal jurisdictions, and finally among specific inter- and intra-state services. This process is governed primarily by the FCC and the RCA rules and regulations. In August 2014, the FCC opened a proceeding to consider whether to modify or eliminate its cost accounting rules. In addition, for more than a decade, the FCC has been considering whether to modify or eliminate these current jurisdictional separations process. These questions remain pending with the FCC. The FCC's decision, when it comes, could indirectly increase or reduce earnings of carriers subject to jurisdictional separations rules by affecting the way costs are divided between regulated and unregulated services, and the way regulated costs are divided between the federal and state jurisdictions. In addition, these changes could affect the ways in which the FCC and RCA evaluate the reasonableness of our regulated rates for telecommunications services.

***Regulation of Broadband Internet Access Services***

In March 2015, the FCC reclassified mass market broadband Internet access services as a telecommunications service, subject to common carrier pricing and other regulations under Title II of the Communications Act, which had historically applied only to traditional telephone service. The FCC thus departed from its long history of treating broadband Internet access services as information services, which are subject to far less intrusive federal oversight, though the FCC has declared its intention not to require broadband Internet access service providers to file federal tariffs or otherwise obtain advance FCC review or approval of the rates, terms, and conditions under which they offer broadband Internet access service. In June 2016, the FCC's decision was upheld on appeal by a panel of the United States Court of Appeals for the District of Columbia Circuit.

The FCC's decision prohibits providers of mass market broadband Internet access service from engaging in certain conduct, as follows:

No blocking of lawful content, applications, services, or non-harmful devices, subject to reasonable network management practices, which must have primarily a technical, rather than business, justification.

No throttling, that is, slowing down or otherwise impairing service based on content, application, service, or use of a non-harmful device, subject to reasonable network management.

No paid prioritization of traffic, for example, favoring some traffic over other traffic in exchange for monetary or other consideration, or to benefit an affiliate. This rule is not subject to reasonable network management.

No unreasonable interference or causing unreasonable disadvantage to end users' ability to select, access, and use broadband Internet access service or the lawful Internet content, applications, services, or devices of their choice, or edge providers' ability to make lawful content, applications, services, or devices available to end users, subject to reasonable network management. The FCC identified seven factors it would consider on a case-by-case basis when applying this rule.

In addition, the FCC's order preserved and expanded requirements to disclose broadband service performance, network management, and applicable commercial terms. Service providers like the Company that have 250,000 or fewer

broadband subscribers are exempt from the disclosure requirements through January 17, 2022.

As a result of this FCC order, much of our broadband Internet access service is now subject to federal laws and regulations that previously have only applied to legacy common carrier telecommunications services, including:

That our rates, terms, and conditions of service be just, reasonable, and not unreasonably discriminatory, although the FCC has offered little guidance on how it will evaluate compliance with these standards;

That we adhere to statutory confidentiality, usage, and disclosure protections that apply to CPNI, such as the quantity, technical configuration, type, destination, location, and amount of use of a customer's broadband Internet access service;

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That our broadband Internet access service meet disabilities access requirements specified by statute;

That we provide broadband Internet access providers with nondiscriminatory access to our poles, ducts, conduits, and rights-of-way formerly available only to telecommunications carriers and cable system operators;

That we adhere to universal service deployment conditions associated with federal universal service support, and may in the future be required to contribute to universal service support mechanisms based on our status as a provider of broadband Internet access services; and

That the FCC has asserted enforcement jurisdiction over disputes concerning our provision of broadband Internet access service, as well as our interconnection and exchange of traffic with other intermediate providers.

Because these legal requirements have never before applied to broadband services, and the FCC's order lacks many specifics, it is difficult for us to assess the full extent of the impact of this new regulatory framework on our business.

### *Data Security and Privacy*

In November 2016, the FCC issued new data privacy and security rules governing service providers' use and sharing of customer data relating to their use of telecommunications services, including mass market broadband Internet access service. In general, these rules supplant the preexisting Federal Trade Commission rules on this subject. The FCC's new rules require detailed disclosure of the service provider's policies regarding the collection, use, and disclosure of information about its customer and that customer's use of the provider's services. The rules divide this information into three sensitivity tiers, based on the FCC's opinion of the level of potential sensitivity of each element of information. Service providers must obtain the appropriate level of consent—either opt-in, opt-out, or none—before using or sharing information in the associated tier. These rules replaced the FCC's legacy CPNI rules, which were focused on voice telephony services. Pending approval from the Office of Management and Budget, the new rules will become effective in stages between now and December 4, 2017, with a further twelve-month extension of time for small mass market broadband Internet access service providers serving fewer than 100,000 connections, and small voice service providers serving fewer than 100,000 lines, to implement the new notice and customer approval rules. In addition, the new FCC Republican majority, as well as members of Congress, have expressed interest in modifying or overturning these new regulations. We are continuing to assess the full extent of the impact of these new rules, if any, on our business.

### *Interconnection with Local Telephone Companies and Access to Other Facilities*

The Communications Act imposes a number of 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; 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 (see the "Interstate Access" discussion below).

All of our LEC subsidiaries are considered incumbent LECs (ILECs) and have additional obligations under the Communications Act: to negotiate in good faith with any carrier requesting interconnection; to provide interconnection for the transmission and routing of telecommunications at any technically feasible point in our ILEC

network on just, reasonable and non-discriminatory rates, terms and conditions; to provide access to unbundled network elements ( UNEs ), such as local loops at non-discriminatory, cost-based rates to competing carriers that would be impaired without them; to offer retail local telephone services to resellers at discounted wholesale rates; to provide notice of changes in information needed for another carrier to transmit and route services using its facilities; and to provide, at rates, terms and conditions that are just, reasonable, and non-discriminatory, physical collocation, which allows a competitive LEC ( CLEC ) to install and maintain its network termination equipment in an ILEC 's central office, or to obtain functionally equivalent forms of interconnection.

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Our ACSN ILEC subsidiary is classified as a rural telephone company under the statute and therefore falls within a federal statutory exemption from the requirements imposed on most ILECs to provide UNEs to a CLEC. The RCA may terminate the exemption if it determines that interconnection is technically feasible, not unduly economically burdensome and consistent with universal service. Although the RCA has not terminated ACSN's UNE exemption, the RCA granted GCI, subject to certain conditions, approval to provide local exchange telephone service in the Glacier State study area and Sitka exchange of ACSN on its own facilities. Other than the City of Sitka, all other exchanges in the Sitka study area remain unserved by any CLEC at this time.

On December 28, 2006, the FCC conditionally and partially granted ACSA forbearance from the obligation to lease UNEs to our competitors. This forbearance was limited to five wire centers within the Anchorage service area. Even where relief was granted, however, the FCC has required ACSA 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. As a result of this decision, on March 15, 2007, our LECs entered into a five-year global interconnection and resale agreement with GCI governing the provision of UNEs and other services. The successor to that agreement remains in effect, and the parties are currently negotiating a newly updated successor agreement that be submitted to the RCA for approval before it takes effect.

On December 28, 2015, the FCC issued an order granting forbearance from certain ILEC obligations under the Communications Act and the FCC's rules. As of that date, the FCC has relieved our ILEC subsidiaries of dialing parity and equal access obligations that, formerly, required us to ensure that customers were able to route their calls to other telecommunications service providers without having to dial additional digits, and to allow each of our ILEC telephone service customers to choose among any available providers of stand-alone interstate long-distance service, which the customer could then reach simply by dialing 1. We must continue to offer those capabilities to any customer that has presubscribed to a stand-alone interstate long-distance provider prior to December 28, 2015, but are not required to make long-distance presubscription available to new customers. This decision is the subject of a Petition for Reconsideration with respect to rural areas of Alaska, which remains pending with the FCC.

In the same order, the FCC granted our ILEC affiliates forbearance in two additional areas: (i) the FCC granted limited forbearance from our ILEC affiliates' obligation to offer competitive access to newly-deployed entrance conduit running from the property line to a commercial building in greenfield situations where no service provider has an established presence; and (ii) our ILECs are no longer required to offer competitors unbundled access to a 64-kilobit-per-second voice channel in areas where we have replaced last mile copper loop connections to our customers with fiber optic cables.

### ***Interstate Access Charges***

The FCC regulates the prices that ILECs charge for the use of their local telephone facilities in originating or terminating interstate calls.

### ***Special Access Pricing Flexibility***

Rates for interstate telecommunications services offered by our ILEC subsidiaries are determined using price cap regulation, under which the rates vary from year to year based on mathematical formulae, and not based on changes to our costs, including both inter-carrier rates and retail end user rates. Since 2010, ACSA, ACSF, and ACSAK have had the right under the FCC's Phase I and Phase II pricing flexibility rules to offer flexible pricing arrangements such as volume and term discounts free from FCC rate structure and price-cap rules for qualifying services, including dedicated transport and special access services in the Anchorage, Juneau and Fairbanks areas. The FCC has since ceased making any new grants of pricing flexibility, and has collected data on the state of competition in the special



access markets to evaluate possible changes. We (and other carriers) filed data sets relating to our local exchange markets in Alaska in February 2015 and responded to further FCC reform proposals during the course of 2016. The FCC was scheduled to consider new pricing flexibility rules at its November 2016 open meeting, but the proposed order was withdrawn from the agenda without consideration. The FCC continues to consider whether to create new or different competitive triggers for pricing flexibility and whether to maintain, expand, or withdraw pricing flexibility that it has previously granted. Because the pricing flexibility currently granted to three of our ILECs could be affected by future changes to the FCC's pricing flexibility rules, any reforms that the FCC adopts could affect the Company's revenues in ways we cannot currently predict.

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### *Transformation Order*

Under a 2011 FCC order (the Transformation Order ), our ILEC interstate and intrastate switched access rates and reciprocal compensation rates ( ICC rates ) are capped and declining toward zero, in pursuit of the FCC's goal that carriers will recover their costs from their end-users and, in some cases, universal service support mechanisms.

The transition unfolds over a six-year period beginning July 1, 2012, and the last two steps of the transition are as follows:

all terminating switched end-office rates and reciprocal compensation rates will be reduced to zero on July 1, 2017; and

for a terminating ILEC that owns the tandem switch, terminating switched end-office rates and terminating switched transport rates will be reduced to \$0.0007 for all traffic within the tandem serving area on July 1, 2017, and to zero on July 1, 2018.

The Transformation Order provides for a certain amount of compensation for lost revenue through two optional programs: (i) an access recovery charge on subscribers and (ii) a temporary access replacement support mechanism with broadband build-out obligations. However, the FCC does not intend the results of the changes to be revenue-neutral to any ILEC and various caps, limitations, market forces and, ultimately, phase-outs apply to both of these programs. Based on these factors, it is difficult to predict the ultimate impact on our future revenues. In a July 2016 Order, the FCC found that ILECs are non-dominant in the market for switched access services nationwide, but declined to provide any significant relief from existing levels of federal regulation as a result of that finding.

### ***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 Company has received universal support in several forms: (i) high cost support received by its ILEC subsidiaries for its wireline voice and broadband Internet access service business under the Connect America Fund; (ii) support for services that the Company provides to schools and libraries, provided through the federal schools and libraries universal service support mechanism ( E-Rate ); (iii) support from the federal Rural Health Care ( RHC ) support mechanism, which supports telemedicine and rural health care communications; and (iv) low-income support under the FCC's Lifeline program, which subsidizes telephone service for low-income consumers.

Historically, the level of high cost support received by the Company's ILEC subsidiaries was based on the costs those subsidiaries incurred in providing telecommunications services, although a portion of the support was frozen at the time our ILEC subsidiaries converted to federal price cap regulation and, for ACSA, based on the results of a cost model. The 2011 Transformation Order made a number of changes, including replacing legacy high cost support mechanisms with the Connect America Fund ( CAF ) mechanism discussed below.

### ***Rural Health Care Universal Service Support Program***

The FCC's Rural Health Care Universal Service Support Mechanism provides funding to help make broadband telecommunications and Internet access services provided by the Company and other service providers affordable for eligible rural health care providers. The program's budget is set at \$400 million annually, a significant portion of which

is used to assist eligible rural health care providers in Alaska. For the 2016 funding year (which began July 1, 2016), the FCC projected that demand for support from this program will exceed the \$400 million cap. As a result, some or all of the rural health care providers that applied for support from the program for this and future funding years may receive a prorated portion of the full amount of support that they seek. This could reduce the affordability of our services to rural health care providers, and potentially reduce demand for our services from these customers in the future, unless the \$400 million budget is increased.

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*CAF Phase I*

The FCC implemented CAF in two primary phases. CAF Phase I froze our LECs' high cost support, beginning in 2012, at the 2011 level, and requires us to use that support to provide broadband fixed services in high cost areas served by our price-cap LEC subsidiaries. Price-cap ILECs, such as ours, must use this frozen support to deploy and operate modern communications networks capable of supporting broadband and voice services, and over time must target areas that are substantially unserved by any unsupported competitor providing such services. Broadband for purposes of CAF Phase I support programs is defined as delivering actual speeds of at least 4 Mbps downstream and 1 Mbps upstream, with latency suitable for real-time services such as Voice over Internet Protocol ( VoIP ), and must be offered at prices reasonably comparable to those in urban areas.

The Transformation Order set the Company's ILEC CAF Phase I frozen support at a level of \$19.7 million annually. In addition, in 2012 and 2013, the FCC made two rounds of additional CAF Phase I Incremental Support available to certain price-cap carriers serving the highest-cost wire centers, conditioned on the carriers deploying additional broadband service to unserved locations (or, in the case of Round 2 support, locations that are served by broadband, but that do not receive actual speeds of at least 3 Mbps/768 kbps) over the three-year period following the award of support.

We completed the required build-out under each of Round 1 and Round 2 within the required three-year period.

*CAF Phase II*

CAF Phase II supplanted the CAF Phase I frozen support mechanism and requires recipients to provide broadband service to unserved locations throughout the designated coverage area by the end of a specified build-out period, and meet interim milestone build-out obligations.

On October 31, 2016, the FCC released its order for Connect America Fund Phase II ( CAF II ) for price cap carriers in Alaska. Alaska Communications is the only price cap carrier in Alaska and, under the CAF II order, Alaska Communications will receive approximately \$19.7 million annually for the next nine years (the same amount it received as CAF I high cost frozen support), in exchange for providing broadband service to approximately 31,500 locations in unserved and partially served census blocks, which will include approximately 26,000 currently unserved locations.

***Lifeline***

Revenue generated from our lifeline customers represented less than 1% of our total revenue for each of the twelve month periods ended December 31, 2016 and 2015. The FCC's Lifeline support mechanism today subsidizes the cost of voice services for low-income consumers, as well as broadband in CAF II locations. The Lifeline mechanism provides a higher level of support for low-income consumers living on Tribal Lands, including the entire state of Alaska. Under reforms adopted in the FCC's January 2012 Lifeline Order, we are required to recertify each of our Lifeline customers annually to verify continued eligibility for Lifeline service. In part as a result of those efforts, our Lifeline enrollment decreased, and we will face continuing compliance obligations with respect to Lifeline customers served by our LEC subsidiaries. There are a number of matters under consideration that could increase the Company's regulatory compliance obligations and customer administrative responsibilities, and impact revenue received from regulatory funding sources.

*Lifeline Reform*

On April 27, 2016, the FCC released the text of new rules making stand-alone broadband service, as well as bundled voice and data service packages, eligible for Lifeline support, in addition to traditional voice service. After receiving approval from the Office of Management and Budget, the rules making Lifeline a supported service took effect on December 2, 2016. The Company's ILECs have obtained forbearance from the FCC obligation to provide Lifeline broadband in those locations not funded by CAF Phase II.

In the same order, the FCC established a process for creating a national Lifeline eligibility verifier, which is expected to become operational in stages over the next several years, potentially reducing our costs of compliance with Lifeline eligibility certification and recertification rules. This order also eliminated a number of qualifying programs approved by state regulatory commissions.

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### ***Wireless Services***

Federal law preempts state and local regulation of the entry of, or the rates charged by, any provider of commercial mobile radio services, which includes personal communications services and cellular services. The regulatory burden associated with our wireless business was removed with the closing of the Wireless Sale.

### ***Other Federal Regulations***

In August 2015, the FCC adopted new rules to govern aspects of the ongoing transition from legacy copper transmission facilities to new IP-based networks. In general, the new rules impose an additional 180-day advance disclosure requirement when incumbent local exchange carriers, such as the Company, plan to retire copper transmission lines connecting to our customers' premises or replace them, in whole or in part, with fiber optic cable. While the effects of this rule on individual deployment projects are difficult to predict, it is possible that the new rule may require us to slow our deployment of broadband facilities in some cases. In addition, in July 2016, the FCC adopted new rules governing the discontinuance of legacy circuit-switched voice services in favor of those based on newer technology, replacing its historical five-factor test with a new, three-factor Adequate Replacement Test that is focused on the performance of the new service that will replace the legacy circuit-switched service. Because the FCC has applied this test on very few occasions, it is difficult for us to assess the full extent of the impact that this new regulation may have on our business, but the new rule could slow our network's evolution from circuit-switched to more modern packet-switched services that customers prefer.

Also in August 2015, with respect to residential, fixed, facilities-based voice services that do not receive electrical power through the telephone line (such as fiber-to-the-home services), the FCC adopted rules requiring us to offer our customers the option to purchase equipment providing eight hours of standby backup power. Within three years, the FCC's rules require us to offer these customers the option to purchase equipment that provides 24 hours of standby backup power.

On June 2, 2015, Congress enacted the USA Freedom Act. This law amended the Foreign Intelligence Surveillance Act of 1978 (FISA), 50 USC § 1801, and certain parts of the U.S. criminal code (18 USC), and supersedes portions of the 2001 USA Patriot Act. Importantly for the Company, the law bans the bulk collection of telephone call detail records, effective 180 days after enactment. The Act addresses circumstances under which telecommunications carriers must produce customer telephone call detail records (some of which the Company does not actually keep, such as call detail for local calling) at the request of law enforcement. The FISA court now will adjudicate requests for such records in most cases. The bill also enacts certain additional changes to existing wiretap laws. Until we gain additional understanding of how it will be administered and implemented, it is difficult for us to assess the full extent of the impact that this new statute may have on our business.

### ***Business Data Services***

On May 2, 2016, the FCC released a Further Notice of Proposed Rulemaking, seeking comment on how to define a market for business data services, the level of competition in that market, and potential new regulation of business data services in markets that are not sufficiently competitive, as measured under that new framework. These regulations may potentially apply both to our traditional circuit-switched dedicated transport services, and more modern packet-based data services, such as Ethernet and MPLS services. Until the FCC adopts final rules in this area, it is difficult for us to assess the cost of compliance or the extent to which these proposals may otherwise affect our business.



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**Table of Contents****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. In addition, RCA approval is required if an entity acquires a controlling interest in any of our certificated subsidiaries, acquires a controlling interest in another intrastate utility or discontinues 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 Eligible Telecommunications Carrier ( ETC ) status for purposes of qualifying for federal USF. The Communications Act specifies that resale and UNE rates are to be negotiated among the parties subject to the approval or arbitration of the RCA. Our ILECs have entered into interconnection agreements with a number of entities.

The FCC's March 2015 order reclassifying broadband Internet access service as a telecommunications service also sought to limit the authority of state regulators over the service by finding that it is jurisdictionally interstate in nature. The FCC prohibited state regulators from imposing new state universal service contribution obligations on broadband Internet access services, and announced its intent to preempt any attempts by state regulators to impose entry certification restrictions, rate regulation, or tariff filing requirements in connection with broadband Internet access service.

***Alaska Universal Service Fund***

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), the COLR, Carrier Common Line ( CCL ) support program and other costs associated with regulated service.

In response to the FCC's order eliminating Lifeline qualifying programs approved by state regulatory commissions, the Alaskan telecommunications industry has proposed a waiver of the state qualifying programs to align the state and federal qualifying programs. The RCA granted that waiver prior to December 2, 2016 when the new rules went into effect. The RCA will open a docket to reform their Lifeline regulations in 2017.

In 2011, the Regulatory Commission of Alaska adopted regulations reducing intrastate access charges but including support for Incumbent Local Exchange Carriers that continue to have COLR responsibilities. This COLR support is provided from the AUSF. Since these regulations were adopted, the AUSF surcharge was increased from 1.32% to 14.2%. A recent request from the Alaska Universal Service Administrative Company ( AUSAC ) to increase the surcharge to 15.1% prompted the RCA to address its concerns about the increase in the surcharge. The RCA granted a mid-course correction in 2016 for 14.2%, and when AUSAC filed its 2017 surcharge tariff, the RCA approved 14.2%.

***Other State Regulatory Matters***

The RCA opened three dockets on July 27, 2016 to investigate the continued need for COLR funding in competitive areas. Two of the dockets investigating the continued need for COLR funding affect the Fairbanks and Juneau markets. This could impact the Company's future COLR support. COLR funding will continue until the RCA has completed its investigation. On December 23 and 27, 2016, the RCA issued orders for ACSAK and ACSF which issued an initial impression that a carrier of last resort was no longer necessary and allowing the companies to respond. The company responded in mid-January 2017 and is awaiting the RCA's decision. A decision by the RCA is



anticipated during the first half of 2017. COLR funding represented approximately 2.4% of our total revenue in 2016. At its January 25, 2017 public meeting, the RCA announced its intention to open an expansive informational docket regarding the Alaska Universal Service Fund in the first quarter of 2017 intended to scope a rulemaking and decision on whether the AUSF is sustainable and whether it should be continued and/or modified.

On December 1, 2015, ACSA petitioned to be designated a non-dominant carrier regarding requirements for line extension, special construction, subdivision agreements and access. The RCA granted ACSA's petition and ACSA subsequently filed a tariff reducing its obligation in the event of a line extension request, special construction or subdivision agreement.

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### **Website Access to Reports**

Our investor relations website Internet address is [www.alsk.com](http://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 Securities Exchange Act of 1934. 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 ( SEC ).

### **Code of Ethics**

We post our code of business conduct and ethics entitled Code of Ethics , on our investor website at [www.alsk.com](http://www.alsk.com). Our code of business conduct and ethics complies with Item 406 of SEC Regulation S-K and the rules of Nasdaq. We intend to disclose any changes to the code that affect the provisions required by Item 406 of Regulation S-K and any waivers of the code of ethics for our executive officers, senior financial officers or directors, on that website.

### **Additional Business Information**

See Item 1A, Risk Factors, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 2 *Sale of Wireless Operations*, Note 3 *Joint Venture* and Note 19 *Business Segments* in the Notes to Consolidated Financial Statements for additional information, which is incorporated herein by reference.

### **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 Relating to Our Industry**

##### **Competition**

*The telecommunications industry in Alaska is competitive and creates pressure on our pricing and customer retention efforts.*

Strong competitors make it more difficult for us to attract and retain customers, which could result in lower revenue, cash flow from operating activities and Adjusted Free Cash Flow.

Our principal facilities-based competitor for voice and broadband services is GCI, who is also the dominant cable television provider in Alaska. In the business and wholesale market, GCI holds a dominant position through its extensive fiber optic, microwave and satellite based middle mile network as well as its undersea fiber cable network, where it owns and operates two of the four existing undersea fiber optic cables connecting Alaska to the contiguous states. In the consumer market, GCI bundles its cable video services with voice, broadband and wireless services. We do not offer video service and wireless, and thus, are unable to offer competing bundles.

GCI continues to expand its statewide reach, including through its Terra Southwest project which is funded with federal subsidies, consisting of grants from the USDA Rural Utilities Service and federal low-interest loans. This subsidy gives GCI a substantial competitive advantage in the markets served by Terra Southwest, and GCI receives substantial additional funding for services offered over this facility from the federal E-Rate and Rural Health Care universal service support mechanisms. GCI has indicated it intends to replicate this government subsidized model in other markets in Alaska, which will create monopoly-type conditions in these markets which are subject to minimal regulatory oversight.

With a long history of operating in Alaska, AT&T has a terrestrial long-haul network in Alaska where the focus is on serving certain national customers. AT&T's primary focus in Alaska is providing wireless services.

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As we compete more extensively in the managed IT services business, we are likely to face new competition, both local and national. An example of this new competition is World Wide Technologies, a large equipment value add reseller. There are many smaller firms that compete for IT business in Alaska. We believe that competition for managed IT services is fragmented in Alaska with no clear or dominant provider.

## **Our New Cost Structure**

*We may not be able to maintain our new cost structure following the Wireless Sale which would create risk to our ability to generate bottom-line growth.*

Subsequent to the Wireless Sale, wind-down of our wireless operations and positioning the Company as a more focused broadband and managed IT services company, we commenced a plan to generate synergies and achieve cost reductions. This plan was substantially implemented during the third and fourth quarters of 2015 and resulting benefits were realized during fiscal year 2016. Maintaining these cost reductions is a critical factor impacting our generation of cash flow from operating activities. If we fail to maintain these cost reductions, our financial condition will be impacted.

## **Technological Advancements and Changes in Telecommunications Standards**

*If we do not adapt to rapid technological advancements and changes in telecommunications standards, our ability to compete could be strained, and as a result, we would lose customers.*

Our success will likely depend on our ability to adapt and fund the rapid technological changes in our 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 changes 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.

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. Some of our competitors may have greater resources to respond to changing technology than we do. 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.

To be competitive we need to maintain an on-going investment program to continuously upgrade our access network. We define the access network as the connection from the end user location either a home or a business to the first aggregation point in the network. The connection can be copper or fiber and the aggregation point is typically a central office or remote serving node. The access network determines the speeds we are able to deliver to our end customer. We may not be able to maintain the level of investment needed for long term competitiveness in offering broadband speeds to all segments of our market.

As we seek to grow as the leading Cloud Enabler for businesses in Alaska, we will have to partner with various IT technology and cloud services providers. Technology trends and developments in this area can be far more disruptive and tend to change in shorter cycles compared to telecommunications technologies. Our ability to invest in the training, certifications, and skills required to develop these partnerships will be important in determining our success in this area of managed IT services.

*Our limited access to middle mile infrastructure limits our ability to compete in certain geographic and customer segments in Alaska.*

We define middle mile as the connection between the first aggregation point into a local community and the interconnection point to the internet or switch which connects the community to the outside world. These are typically high capacity connections and can span hundreds of miles in the case of Alaska. It is unlikely that we will have the capital needed for middle mile investments, and GCI controls significant elements of the middle mile network in Alaska, and through its government funded programs is creating monopoly conditions in certain areas of the state. This limits our ability to compete in certain markets.

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### **Risks Relating to Our Debt**

*Our debt could adversely affect our financial health, financing options and liquidity position, and our ability to service debt is, in part, dependent on maintaining the synergies achieved following the Wireless Sale. Due to uncertainty in the capital markets, we may be unable to retire or refinance our long-term debt when it becomes due, or if we are able to refinance it, we may not be able to do so with attractive interest rates or terms.*

The following discussion addresses our debt prior to entering into the new senior credit facility in March 2017 as described below.

Since 2012 we have been aggressively reducing the amount of our outstanding debt. As of December 31, 2016, we had total debt of \$181.8 million, net of debt discounts. The Wireless Sale resulted in \$240.5 million of debt reductions. In the third quarter of 2015, we entered into a combined \$100.0 million of senior secured financing. Proceeds of \$81.5 million and \$10.0 million were used to repay in full the remaining balance of our 2010 Senior Credit Facility and purchase a portion of our 6.25% Convertible Notes due 2018 ( 6.25% Notes ), respectively. In 2016, we repurchased our 6.25% Notes in the principal amount of \$10.0 million for \$9.8 million and made scheduled principal payments on the First Lien Term Loan of our 2015 Senior Credit Facility totaling \$3.0 million. At December 31, 2016, our debt consists of \$86.8 million under the senior secured credit facilities, \$94.0 million of 6.25% Notes (\$91.7 million net of discounts) and \$3.3 million of capital lease obligations.

Our debt obligations prior to the 2017 refinancing required the following:

Maintain a fixed amortization schedule of principal payments on our 2015 Senior Credit Facilities of \$4,000 in 2017.

Perform against financial covenants under our 2015 Senior Credit Facilities.

The term loan components of our 2015 Senior Credit Facilities of \$65.0 million and \$25.0 million, net of scheduled payments described above, mature on January 2, 2018 and March 3, 2018, respectively. Our revolving loan facility, which is undrawn, matures on January 2, 2018. The maturity dates on our 2015 Senior Credit Facilities may be extended to 2020 if the Company meets certain Convertible Note repurchase targets and liquidity requirements. Our Convertible notes are not callable and limit our flexibility with strategic acquisitions. Pursuant to the 2017 Senior Credit Facility (described below), the Company intends to commence a tender offer for its outstanding 6.25% Notes. The offer will commence upon the filing of Schedule TO with the Securities and Exchange Commission. The outstanding principal balance of the 6.25% Notes was \$94.0 million at December 31, 2016.

Our debt also exposes us to adverse changes in interest rates. As a component of our cash flow hedging strategy and as required under the terms of the 2015 Senior Credit Facilities, we hold a pay-fixed, receive-floating interest rate swap in the notional amount of \$42.8 million at 5.833%, inclusive of a 4.5% LIBOR spread, for the period December 2015 through December 2017. Under the terms of the 2017 Senior Credit Facility (described below), we are required to hedge a portion of the variable rate interest payments.

#### *2017 Senior Credit Facility*

On March 13, 2017, we entered into a senior credit facility consisting of a Term A-1 Facility of \$120.0 million, a Term A-2 Facility of \$60.0 million and a Revolving Facility of \$15.0 million (together the 2017 Senior Credit Facility

or Agreement ). Upon the satisfaction of certain conditions, on or before March 28, 2017, we will utilize proceeds from the 2017 Senior Credit Facility and cash on hand to repay in full our 2015 Senior Credit Facilities, including accrued interest and fees, of approximately \$87.8 million, fund the tender of our 6.25% Notes in the amount of \$94.0 million and fund fees and expenses associated with this transaction.

Principal payments on the Term A-1 Facility are \$1,500 thousand per quarter beginning in the fourth quarter of 2017 through the first quarter of 2020, \$2,250 thousand per quarter beginning in the second quarter of 2020 through the first quarter of 2021, and \$4,000 thousand per quarter beginning in the

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second quarter of 2021 through the fourth quarter of 2021. The remaining outstanding principal balance is due on March 13, 2022. Principal payments on the Term A-2 Facility are \$150 thousand per quarter beginning in the fourth quarter of 2017 through the first quarter of 2021 and \$600 thousand per quarter beginning in the second quarter of 2021 through the fourth quarter of 2022. The remaining outstanding principal balance is due on March 13, 2023.

The 2017 Senior Credit Facility also requires that we perform against certain financial covenants.

See the Credit Agreement dated as of March 13, 2017, by and among Alaska Communications, as the borrower, the Company and certain of its direct and indirect subsidiaries, as guarantors, ING Capital LLC, as administrative agent, and the lenders party thereto filed as Exhibit 10.1 to the Current Report on Form 8-K filed on March 15, 2017 and Note 22 *Subsequent Events* in the Notes to Consolidated Financial Statements, which are incorporated herein by reference, for additional information.

Continuing global, national, and state fiscal insecurity, as well as uncertainty regarding our future performance adds refinancing risk to the Company.

We are also subject to credit risk related to our counterparties on the swaps and to interest rate fluctuations on interest generated by our debt in excess of the notional term loans referenced above. For more specific information related to our exposure to changes in interest rates and our use of interest rate swaps, please see Item 7A, Quantitative and Qualitative Disclosures About Market Risk.

## **Risks Related to our Business**

### **Access and High Cost Support Revenue**

*Revenues from access charges will continue to decline and revenue from various regulated support mechanisms is subject to rule changes at the FCC and the RCA.*

We received approximately 2.5% and 2.8% of our operating revenues for the years ended December 31, 2016 and 2015, respectively, from 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. Access charges have consistently decreased in past years and we expect this trend to continue due to declines in voice usage and migration to VoIP services which do not generate access revenue for us.

Interstate switched access has been on a phase-out schedule for several years, and according to the schedule set forth by the FCC, it will reach its final phase in July 2017. Interstate switched access is currently a relatively small component of all access revenue, and modest declines are anticipated at this time for other components of interstate access revenue. Traditional intrastate access revenues have already been reduced, replaced in part by COLR support. The RCA has commenced a proceeding that could impact COLR support in the future, and while it is impossible to predict the state commission's future decisions, there is a risk that revenue will be reduced.

Furthermore, the FCC has actively reviewed new mechanisms for inter-carrier compensation that will eliminate certain access charges entirely. Elimination of access charges would have a material adverse effect on our revenue and earnings. Similarly, the RCA has adopted regulations modifying intrastate access charges that may reduce our revenue.

As discussed in Regulations, the FCC released its order for CAF II on October 31, 2016. As a result, we currently expect our high cost support revenue to be relatively unchanged for the next nine years. Substantial changes are



expected to be enacted by the FCC regarding our future high cost loop support funding and obligations thereunder. It is difficult to predict the future growth in this source of revenue as well as the future obligations that we will be required to accept that are tied to this funding.

### **Regulations**

*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 in a timely manner with these new regulations.*

Some of our markets are regulated and we cannot predict the extent to which the government will impose

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new unfunded mandates on us. Such mandates have included those related to emergency location, emergency E-911 calling, 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 or other regulatory mandates. 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. For more information on our regulatory environment and the risks it presents to us, see Item 1, Business Regulation .

*There is a risk that FCC Orders will materially impact our revenue.*

On May 2, 2016, the FCC released a Further Notice of Proposed Rulemaking regarding business data services, the level of competition in that market, and potential new regulations in markets that are not sufficiently competitive. There is a risk any FCC regulations eventually adopted may impact our business services revenue. Until the FCC adopts final rules in this area, it is difficult for us to assess the likely impact of any new regulations in this area.

The 2011 Transformation Order established a new framework for high cost universal service support that replaced existing support mechanisms that provide support to carriers, like us, that serve high-cost areas with new CAF support mechanisms and service obligations that are focused on broadband Internet access services. We recognized \$19.7 million in federal high cost universal service payment revenues to support our wireline operations in high cost areas in each of the twelve months ended December 31, 2016 and 2015. The FCC released its CAF Phase II order on October 31, 2016. In addition, in March 2015, the FCC reclassified broadband Internet access service as a telecommunications service that is now subject to a substantial body of legacy regulations that formerly applied only to traditional circuit switched telephone services. See the heading Regulation, above, for more detailed information.

In addition, the FCC has imposed strict new compliance requirements governing enrollment of low-income subscribers in the FCC's Lifeline program, which provides carriers like us with USF support to reduce the cost of wireline and wireless services to low-income consumers. For the twelve months ended December 31, 2016, we recognized wireline lifeline revenue of \$0.4 million. Over the same period the number of Lifeline customers we served shifted from 1,402 wireline and 5,616 wireless lifeline customers to 1,131 wireline and zero wireless Lifeline customers. Following the February 2015 completion of the sale of our wireless business, we no longer serve any wireless Lifeline customers. We expect the amount of Lifeline USF support we receive in connection with our wireline customers to continue to decrease, because we expect that it will be more difficult for low-income consumers to qualify for Lifeline, and to remain enrolled in Lifeline, than it was under the former rules.

## **Economic Conditions**

*The successful operation and growth of our businesses depends on economic conditions in Alaska which may deteriorate due to reductions in crude oil prices and other factors.*

The vast majority 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 Alaska economy, in turn, depends upon many factors, including:

the strength of the natural resources industries, particularly oil production and prices of crude oil;

the strength of the Alaska tourism industry;

the level of government and military spending; and

the continued growth of service industries.

The population of Alaska, which grew marginally in 2016, is approximately 740,000 with Anchorage, Fairbanks and Juneau serving as the primary population and economic centers in the state.

It is estimated that one-third of Alaska's economy is dependent on federal spending, one-third on natural resources, in particular the production of crude oil, and the remaining one-third on drivers such as tourism, mining, timber, seafood, international air cargo and miscellaneous support services.

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Alaska's economy is dependent on investment by oil companies, and state tax revenues correlate with the price of oil as the State assesses a tax based on the retail price of oil that transits the pipeline from the North Slope. The price of crude oil dropped substantially during the past three years and began to stabilize in 2016. This is primarily impacting the state in two ways:

1. Resource based companies are reducing their level of spending in the state, and in particular the North Slope, through reducing their operating costs. In flight development projects are continuing, however, should the price of oil remain at its current levels, spending on future development is expected to be lower.
2. The State of Alaska budget, which represents approximately 15% of the states total economy, is incurring deficits, but has established budgetary reserves that are available through 2017. Proposals to address these deficits include spending reductions, utilization of earnings from the state's permanent fund and additional revenues, including selected income taxes. Reduced spending by the State is expected to have a dampening effect on overall economic activity in the state.

Economists believe the Alaskan economy entered a moderate recession beginning in the second half of 2015. They are currently projecting that this recession will continue through at least 2017. Employment levels in the state declined approximately 2.3% in 2016, driven by declines in the oil and gas industry, construction, professional services and state government, and are expected to decline by a similar amount in 2017. The negative effects of the recession have been mitigated by diversity in the Alaskan economy, including growth in the health care and tourism industries.

Our terrestrial fiber network on the North Slope of Alaska (described below) which allows us to provide broadband solutions to the oil and gas sector may be negatively impacted by declining crude oil prices in the near term. Additionally, overall macro impacts from a sustained lower price of crude oil, if maintained over time, will ultimately impact our growth in the future.

### **North Slope Fiber Optic Network**

*Our joint venture with Quintillion Holdings, LLC established, in part, to provide broadband solutions to the North Slope of Alaska may not prove to be as successful as currently anticipated.*

During the second quarter of 2015, we acquired a fiber optic network on the North Slope of Alaska and entered into a joint venture with Quintillion to operate and expand the network. This network enables commercially-available, high-speed connectivity where only high-cost microwave and satellite communications were previously available. The success of this joint venture is dependent, in part, on the utilization of the network by other telecom carriers.

Quintillion is investing in a fiber optic system with contemplated landing stations in several northwest Alaska communities, including a link from the North Slope to Fairbanks. Delays in the completion of this system could impact our ability to acquire capacity on the North Slope to Fairbanks segment, thereby negatively impacting our market potential in that region.

### **Erosion of Access Lines**

*We provide services to many customers over access lines, and if we continue to lose access lines, our revenues, earnings and cash flow from operating activities 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 the rate of loss has been accelerating. During the years ended December 31, 2016 and 2015 our business access line erosion was 2,621 and 2,570, respectively, while over the same period our consumer access line erosion was 4,265 and 6,090 respectively. We expect to continue to experience net access line loss in our markets, affecting our revenues, earnings and cash flow from operating activities.

#### **Network / E-911 Failure**

*A failure of our network 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. Our network and infrastructure are constantly at risk of physical damage as a result of human, natural or other factors. These factors may include pandemics, acts of terrorism, sabotage, natural disasters, power

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surges or outages, software defects, contractor or vendor failures, labor disputes and other disruptions that may be beyond our control. 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. Further, we may not have adequate insurance coverage, which would result in unexpected expense. Notably, similar to other undersea fiber optic cable operators, we do not carry insurance that would cover the cost of repair of our undersea cables and, thus, we would bear the full cost of any necessary repairs.

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

We provide E-911 service to our customers where such service is available. We also contract from time to time with municipalities to upgrade their dispatch capabilities such that those facilities 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 dispatchers 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.

## **Employees**

*We depend on the availability of personnel with the requisite level of technical expertise in the telecommunications industry.*

Our ability to develop and maintain our networks and execute our business plan is dependent on the availability of technical engineering, IT, service delivery and monitoring, product development, sales, management, finance and other key personnel within our geographic location.

*Labor costs and the terms of our principal collective bargaining agreement can negatively impact our ability to remain competitive, which could cause our financial performance to suffer.*

Labor costs are a significant component of our expenses and, as of December 31, 2016, approximately 56% of our workforce is represented by the IBEW. We believe our labor costs are higher than our competitors who employ a non-unionized workforce because we are required by the CBA to contribute to the IBEW Health and Welfare Trust and the Alaska Electrical Pension Fund ( AEPF ) for benefit programs, including defined benefit pension plans and health benefit plans, that are not reflective of the competitive marketplace. Furthermore, work rules under the existing agreement limit our ability to efficiently manage our workforce and make the incremental cost of work performed outside normal work hours high. In addition, we may make strategic and operational decisions that require the consent of the IBEW. While we believe our relationship with the IBEW is constructive, and although the IBEW generally has provided necessary consents, the IBEW may not provide consent when we need it, it may require additional wages, benefits or other consideration be paid in return for its consent, or it may call for a work stoppage against the Company.

The CBA with the IBEW expired on December 31, 2016. As of the date of this report, negotiations for a new agreement are continuing, and the parties will operate under the terms of the prior agreement until a new contract is in place. The CBA included provisions that allow us to be more cost competitive in certain areas. The IBEW has entered into several agreements with us over the last year which have provided for isolated cost savings; however, we face resistance to changes that are essential for our future success. Should we not reach agreement with the IBEW on a new collective bargaining agreement that allows us to be competitive, our future financial results may be impacted. In the event of a work stoppage, we may be required to utilize cash on hand to support the funding of operations during the

affected period.

In addition, the IBEW has brought unfair labor practice complaints and may continue to bring grievances to binding arbitration. The IBEW may also bring court actions and may seek to compel us to engage in the bargaining processes where we believe we have no such obligation. If successful, there is a risk these administrative, judicial or arbitral avenues could create additional costs that we did not anticipate.

## **Vendors**

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

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We depend on a limited number of suppliers and vendors for equipment and services for our network and certain customer services. If suppliers of our equipment or providers of services on which we rely experience financial difficulties, service or billing interruptions, patent litigation or other problems, subscriber growth and our operating results could suffer.

Suppliers that use proprietary technology, effectively lock us into one or a few suppliers for key network components. Other suppliers require us to maintain exclusive relationships under a contract. As a result, we have become reliant upon a limited number of suppliers of network equipment. 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.

## **Networks, Monitoring Centers and Data Hosting Facilities**

*Maintaining the Company's networks, around the clock monitoring centers and data hosting facilities requires significant capital expenditures, and our inability or failure to maintain and upgrade our networks and data centers would have a material impact on our market share and ability to generate revenue.*

The Company currently operates an extensive network that includes monitoring and hosting facilities. To provide contractual levels of service to our customers and remain competitive, we must expend significant amounts of capital. In many cases, we must rely on outside vendors whose performance and costs may not be sufficiently within our control.

## **Information Technology Systems**

*A failure of back-office IT systems could adversely affect the Company's results of operations and financial condition.*

The efficient operation of the Company's business depends on back-office IT systems. The Company relies on back-office IT systems, including certain systems provided by third party vendors, to effectively manage customer billing, business data, communications, supply chain, order entry and fulfillment and other business processes. Some of these systems are no longer supported under maintenance agreements from the underlying vendor. A failure of the Company's IT systems, or the IT systems provided by third party vendors, to perform as anticipated could disrupt the Company's business and result in a failure to collect accounts receivable, transaction errors, processing inefficiencies, and the loss of sales and customers, causing the Company's reputation and results of operations to suffer. In addition, IT systems may be vulnerable to damage or interruption from circumstances beyond the Company's control, including fire, natural disasters, systems failures, security breaches and viruses. Any such damage or interruption could have a material adverse effect on our business, operating results, margins and financial condition.

## **Undersea Fiber Optic Cable Systems**

*If failures occur in our undersea fiber optic cable systems, our ability to immediately restore our service may be limited.*

Our undersea fiber optic cable systems carry a large portion of our traffic to and from the contiguous lower 48 states. If a failure occurs and we are not able to secure alternative facilities, some of the communications services we offer to our customers could be interrupted, which could have a material adverse effect on our business, financial position, results of operations or liquidity.



## **Managed IT Services**

*Our expansion into managed IT services may not be achieved as planned which could impact our ability to grow revenue.*

We are expanding our business to provide more managed IT services along with our traditional telecom services. The delivery of professional services is not without risk, and it is possible that we may fail to execute on one or more managed IT service projects exposing the company to legal claims and reputational risk.

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### **Intellectual Property**

*Third parties may claim that the Company is infringing upon their intellectual property, and the Company could suffer significant litigation or licensing expenses or be prevented from selling products.*

Although the Company does not believe that any of its products or services infringe upon the valid intellectual property rights of third parties, the Company may be unaware of intellectual property rights of others that may cover some of its technology, products or services. Any litigation growing out of third party patents or other intellectual property claims could be costly and time consuming and could divert the Company's management and key personnel from its business operations. The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. Resolution of claims of intellectual property infringement might also require the Company to enter into costly license agreements. Likewise, the Company may not be able to obtain license agreements on acceptable terms. The Company also may be subject to significant damages or injunctions against development and sale of certain of its products. Further, the Company often relies on licenses of third party intellectual property for its businesses. The Company cannot ensure these licenses will be available in the future on favorable terms or at all. If any of these risks materialize, it could have a material adverse effect on our business, operating results, margins and financial condition.

### **Security Breaches**

*A failure in or breach of our operational or security systems or infrastructure, or those of third parties, could disrupt our businesses, result in the disclosure of confidential information or damage our reputation. Any such failure also could have a significant adverse effect on our cash flows, financial condition, and results of operations.*

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, the security of our computer systems, software and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses or other malicious code and other events that could have a security impact. Additionally, breaches of security may occur through intentional or unintentional acts by those having authorized or unauthorized access to confidential or other information. If one or more such events occur, this potentially could jeopardize our information or our customers' information processed and stored in, and transmitted through, our computer systems and networks. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures arising from operational and security risks, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us.

With regard to the physical infrastructure that supports our operations, we have taken measures to implement backup systems and other safeguards, but our ability to conduct business may be adversely affected by any disruption to that infrastructure. Such disruptions could involve electrical, communications, internet, transportation or other services used by us or third parties with whom we conduct business. The costs associated with such disruptions, including any loss of business, could have a significant adverse effect on our results of operations or financial condition.

Any of these operational and security risks could lead to significant and negative consequences, including reputational harm as well as loss of customers and business opportunities, which in turn could have a significant adverse effect on our businesses, financial condition and results of operations.

*Cyber-attacks may damage our networks or breach customer and other proprietary data, leading to service disruption, harm to reputation, loss of customers, and litigation over privacy violations.*

All industries that rely on technology in customer interactions are increasingly at risk for cyber-attacks. A cyber-attack could be levied against our network, causing disruption of operations and service, requiring implementation of greater network security measures, and resulting in lost revenue due to lost service. A cyber-attack could also be targeted to infiltrate customer proprietary and other data, breaching customer privacy, resulting in misuse of customer information and other data, and possibly leading to litigation over privacy breaches and causing harm to the Company's reputation. We rely on a variety of procedures to guard against cyber-attacks, but the frequency of threats from these attacks is growing globally and the risk to us is also growing.

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### **Pension Plans**

*We may incur substantial and unexpected liabilities arising out of our pension plans.*

Our pension plans could result in substantial liabilities on our balance sheet. These plans and activities have and will generate substantial cash requirements for us and these requirements may increase beyond our expectations in future years based on changing market conditions. The difference between projected plan obligations and assets, or the funded status of the plans, is a significant factor in determining the net periodic benefit costs of our pension plans and the ongoing funding requirements of those plans. Changes in interest rates, mortality rates, health care costs, early retirement rates, investment returns and the market value of plan assets can affect the funded status of our defined benefit pension and cause volatility in the net periodic benefit cost and future funding requirements of the plans. In the future, we may be required to make additional contributions to our defined benefit plan. Plan liabilities may impair our liquidity, have an unfavorable impact on our ability to obtain financing and place us at a competitive disadvantage compared to some of our competitors who do not have such liabilities and cash requirements.

Our most significant pension plan is the AEPF in which we participate on behalf of substantially all of our employees. The AEPF is a multi-employer pension plan to which we make fixed, per employee, contributions through our collective bargaining agreement with the IBEW, which covers our IBEW represented workforce, and a special agreement, which covers most of our non-represented workforce. Because our contribution requirements are fixed, we cannot easily adjust our annual plan contributions to address our own financial circumstances. Currently, this plan is not fully funded, which means we may be subject to increased contribution obligations, penalties, and ultimately we could incur a contingent withdrawal liability should we choose to withdraw from the AEPF for economic reasons. Our contingent withdrawal liability is an amount based on our pro-rata share among AEPF participants of the value of the funding shortfall. This contingent liability becomes due and payable by us if we terminate our participation in the AEPF. Moreover, if another participant in the AEPF goes bankrupt, we would become liable for a pro-rata share of the bankrupt participant's vested, but unpaid, liability for accrued benefits for that participant's employees. This could result in a substantial unexpected contribution requirement and making such a contribution could have a material adverse effect on our cash position and other financial results. These sources of potential liability are difficult to predict.

Given the complexity of pension-related matters we may not, in every instance, be in full compliance with applicable requirements.

### **Key Members of Senior Management**

*We depend on key members of our senior management team; our performance could be adversely impacted if they depart and we cannot find suitable replacements.*

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 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. Our remote location also presents a challenge to us in attracting new talent. 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.

### **Future Acquisitions**

*Future acquisitions could result in operating and financial difficulties.*

Our future growth may depend, in part, on acquisitions. To the extent that we grow through acquisitions, we will face the operational and financial risks that commonly accompany that strategy. We would also face operational risks, such as failing to assimilate the operations and personnel of the acquired businesses, disrupting their ongoing businesses, increasing the complexity of our business, and impairing management resources and management's relationships with employees and customers as a result of changes in their ownership and management. Further, the evaluation and negotiation of potential

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acquisitions, as well as the integration of an acquired business, may divert management time and other resources. Some acquisitions may not be successful and their performance may result in the impairment of their carrying value.

### **Volatility Risks Related to our Common Stock**

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

The trading price of our common stock has been impacted by factors, many of which are beyond our control, including actual or anticipated variations in quarterly financial results, changes in financial expectations by securities analysts and announcements by our current and future competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments. In addition, our financial results in the future may be below the expectations of securities analysts and investors. Broad market and industry factors could also negatively affect the price of our common stock regardless of our operating performance. Future volatility in our stock price 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.

### **Declines in our Market Capitalization or Share Price**

*Declines in our market capitalization or share price may affect our ability to access the capital markets.*

Our ability to issue convertible notes is, in part, a function of our share price and market capitalization, as is our ability to be listed on a national stock exchange. To the extent either declines substantially, our ability to access the capital markets may be impaired.

### **Location Specific Risk**

*We operate in remote areas subject to geologic instability and other natural events which could negatively impact our operations.*

Many of our operations are located in areas that are prone to earthquakes, fires, and other natural disturbances. Many of these areas have limited emergency response assets and may be difficult to reach in an emergency situation. Should an event occur, it could be weeks or longer before remediation efforts could be implemented, if they could be implemented at all. The scope and risk of such an event occurring is difficult to gauge.

### **Internal Control Over Financial Reporting**

*Our internal control over financial reporting may not be effective, which could cause our financial reporting to be unreliable.*

Because of its inherent limitations, and irrespective of the existence of material weaknesses, our internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that such controls may become inadequate because of changes in conditions, or the degree of compliance with policies and procedures may deteriorate. Any of these circumstances could cause our financial reporting to be unreliable.

### **Item 1B. Unresolved Staff Comments**

None



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Our principal properties do not lend themselves to simple description by character and location. The components of our gross investment in property, plant and equipment consisted of the following as of December 31, 2016 and 2015:

(in thousands)	2016	2015
Land, buildings and support assets	\$ 197,999	\$ 198,485
Central office switching and transmission	383,809	381,511
Outside plant, cable and wire facilities	734,786	722,582
Other	7,101	5,207
Construction work in progress	26,204	29,313
	\$ 1,349,899	\$ 1,337,098

Our property, plant and equipment are used in our communications networks.

Land, buildings and support assets consist of land, land improvements, central office and certain administrative office buildings as well as general purpose computers, office equipment, vehicles and other general support equipment. Central office switching and transmission and wireless switching and transmission consist primarily of switches, routers and transmission electronics for our regulated and wireless entities, respectively. Outside plant and cable and wire facilities include primarily conduit and cable. We own substantially all of our telecommunications equipment required for our business. However, we lease certain facilities and equipment under various capital and operating lease arrangements when the leasing arrangements are more favorable to us than purchasing the assets.

We own and lease office facilities and related equipment for our headquarters, central office buildings and operations in locations throughout Alaska and Oregon. Our principal executive and administrative offices are located in Anchorage, Alaska. We believe we have appropriate easements, rights-of-way and other arrangements for the accommodation of our pole lines, underground conduits, aerial, underground and undersea cables, and wires. However, these properties do not lend themselves to simple description by character and location.

In addition to land and structures, our property consists of equipment necessary for the provision of communication services. This includes central and IP office equipment, customer premises equipment and connections, towers, pole lines, remote terminals, aerial, underground and undersea cable and fiber optic and copper wire facilities, vehicles, furniture and fixtures, computers and other equipment. We also own certain other communications equipment held as inventory for sale or lease. Substantially all of our communications equipment and other network equipment are located in buildings that we own or on land within our local service coverage area.

We have insurance to cover certain losses incurred in the ordinary course of business, including excess general liability, property coverage including business interruption, director and officers and excess employment practices liability, excess auto, crime, fiduciary, workers compensation and non-owned aircraft insurance in amounts and with deductibles that are typical of similar operators in our industry and with reputable insurance providers. Central office equipment, buildings, furniture and fixtures and certain operating and other equipment are insured under a blanket property insurance program. This program provides substantial limits of coverage against all risks of loss including fire, windstorm, flood, earthquake and other perils not specifically excluded by the terms of the policies. As is typical in the communications industry, we are self-insured for damage or loss to certain of our transmission facilities, including our buried, undersea and above ground transmission lines. We self-insure with respect to employee health



insurance, primary general liability, primary auto liability and primary employment practices liability subject to stop-loss insurance with insurance carriers that caps our liability at specified limits. We believe our insurance coverage is adequate; however, if we become subject to substantial uninsured liabilities due to damage or loss to such facilities, our financial position, results of operations or liquidity may be adversely affected.

Substantially all of our assets (including those of our subsidiaries) have been pledged as collateral for our 2015 Senior Credit Facilities.

**Table of Contents****Item 3. Legal Proceedings**

We are involved in various claims, legal actions, personnel matters 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 a liability for estimated litigation costs of \$1.3 million as of December 31, 2016, against certain current claims and legal actions. We believe that the disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, comprehensive income or cash flows. It is the Company's policy to expense costs associated with loss contingencies, including any related legal fees, as they are incurred.

**Item 4. Mine Safety Disclosures**

Not applicable.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on the Nasdaq Global Select 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 Nasdaq.

<b>2016 Quarters</b>	<b>High</b>	<b>Low</b>	<b>2015 Quarters</b>	<b>High</b>	<b>Low</b>
4 <sup>th</sup>	\$ 1.80	\$ 1.49	4 <sup>th</sup>	\$ 2.49	\$ 1.70
3 <sup>rd</sup>	\$ 1.85	\$ 1.64	3 <sup>rd</sup>	\$ 2.41	\$ 1.89
2 <sup>nd</sup>	\$ 1.97	\$ 1.64	2 <sup>nd</sup>	\$ 2.58	\$ 1.64
1 <sup>st</sup>	\$ 1.90	\$ 1.30	1 <sup>st</sup>	\$ 1.87	\$ 1.50

As of March 6, 2017, there were 52.0 million shares of our common stock issued and outstanding and approximately 385 record holders of our common stock. Because brokers and other institutions hold many of our shares of existing common stock on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

**Dividends**

In the fourth quarter of 2012, our Board of Directors suspended the quarterly dividend paid to shareholders. The dividend suspension was required in connection with the amendment to our 2010 Senior Credit Facility as part of the AWN transaction. Under the terms of our 2015 Senior Credit Facilities, payment of cash dividends on our common stock was not permitted until such time that the Company's Net Total Leverage Ratio is not more than 2.75 to 1.00 and certain other liquidity measures are met. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Our Net Total Leverage Ratio was higher than 2.75 at December 31, 2016.

Payment of cash dividends is also limited under the 2017 Senior Credit Facility. See the Credit Agreement dated as of March 13, 2017, by and among Alaska Communications, as the borrower, the Company and certain of its direct and indirect subsidiaries, as guarantors, ING Capital LLC, as administrative agent, and the lenders party thereto filed as

Exhibit 10.1 to the Current Report on Form 8-K filed on March 15, 2017.

Our ability to re-institute dividend payments in the future will depend on future competitive market and economic conditions and financial, business, regulatory and other factors, many of which are beyond our control.

Additional factors that may affect our future dividend policy include:

our reliance on dividends, interest and other payments, advances and transfer of funds from our subsidiaries to meet our debt service and pay dividends, if any;

reductions in the availability of cash due to changes in our operating earnings, working capital requirements and anticipated cash needs;

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the discretion of our Board of Directors; and

restrictions under Delaware law.

Notably, nothing requires us to declare or pay dividends. Our stockholders have no contractual or other legal right to dividends.

See Item 1A, Risk Factors Volatility Risks Related to our Common Stock .

**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.

**Common Stock Performance Graph**

The stock performance information required under this item is incorporated into this Form 10-K by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders.

**Item 6. Selected Financial Data**

The following selected consolidated financial data should be read in conjunction with our Consolidated Financial Statements and the Notes thereto in Item 15, Exhibits, Financial Statement Schedules, and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of this report. We derived the selected consolidated financial data from our audited consolidated financial statements.

(in thousands, except per share amounts)	2016	2015	2014	2013	2012
<b>Operating Data:</b>					
Operating revenues <sup>(1)</sup>	\$ 226,866	\$ 232,817	\$ 314,863	\$ 348,924	\$ 367,714
Net income (loss) attributable to Alaska Communications <sup>(1)</sup>	2,386	12,954	(2,780)	158,471	17,409
Income (loss) per share - basic <sup>(1)</sup>	\$ 0.05	\$ 0.26	\$ (0.06)	\$ 3.37	\$ 0.38
Income (loss) per share - diluted <sup>(1)</sup>	\$ 0.05	\$ 0.25	\$ (0.06)	\$ 2.78	\$ 0.38
Cash dividends declared per share	\$	\$	\$	\$	\$ 0.15
<b>Balance Sheet Data (end of period):</b>					
Total assets <sup>(1)</sup>	\$ 442,360	\$ 463,601	\$ 730,280	\$ 747,320	\$ 614,727
Long-term debt, including current portion <sup>(2)</sup>	181,804	193,105	433,968	456,257	555,400

(1) Results in 2015 and 2014 were affected by the formation of AWN in 2013 and the sale of Wireless operations in 2015. See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 2 *Sale of Wireless Operations* and Note 6 *Equity Method Investments* in the Notes to Consolidated Financial Statements.

(2)

Amounts do not reflect the classification of deferred debt issuance costs as a deduction from debt as presented in the consolidated financial statements. See Note 11 *Long-Term Obligations* in the Notes to Consolidated Financial Statements.

## **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.

### **OVERVIEW**

Over the past five years, through a series of transactions and investments, we have evolved from a wireline telecom provider to a fiber broadband and managed IT services provider, primarily to business and wholesale customers in and out of Alaska. We also provide telecommunication services to consumers throughout the state. Our facilities based communications network extends throughout Alaska and connects to the contiguous states via our two diverse undersea fiber optic cable systems. Our network is among the most expansive in Alaska and forms the foundation of service to our customers. We

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operate in a largely two-player terrestrial wireline market and we estimate our market share to be less than 25% statewide. However, our revenue performance relative to our largest competitor suggests that we are gaining market share in the markets we are serving.

The sections that follow provide information about important aspects of our operations and investments and include discussions of our results of operations, financial condition and sources and uses of cash. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information we use in evaluating our own performance and allocating our resources.

We operate in a geographically diverse state with unique characteristics. We monitor the state of the economy in general. In doing so, we compare Alaska economic activity with broader economic conditions. In general, we believe that the Alaska telecommunications market, as well as general economic activity in Alaska, is affected by certain economic factors, which include:

investment activity in the oil and gas markets and the price of crude oil

tourism levels

governmental spending and activity of military personnel

the price and price trends of bandwidth

the growth in demand for bandwidth

decline in demand for voice and other legacy services

local customer preferences

unemployment levels

housing activity and development patterns

We have observed variances in the factors affecting the Alaska economy as compared to the U.S. as a whole. Some factors, particularly the price of oil and gas, have a greater direct impact on the Alaska economy compared to other macro-economic trends impacting the U.S. economy as a whole.

Historically, the Alaska economy has benefited from a stable employment base, including a growing tourism industry. However, economic indicators are being impacted by the substantial decline in the price of crude oil. The Alaskan

economy entered a moderate recession beginning in the second half of 2015, which is currently projected to continue through at least 2017. While the population of Alaska grew marginally in 2016, employment levels declined approximately 2.3% in 2016, driven by declines in the oil and gas industry, construction, professional services and state government. State revenue relies on tax revenue from the production of crude oil and investment in resource development projects by exploration companies in Alaska. Proposals to address recent budget deficits by the State of Alaska include additional revenue through alternative tax sources, including selected income taxes, spending reductions and utilization of earnings from the state's permanent fund. The State of Alaska has also built certain budgetary reserves that are available through 2017. In the long term, this dynamic will impact the overall economy and our future financial performance.

Management estimates the Alaska wireline telecom and IT services market to be approximately \$1.6 billion. This market is comprised of the IT services market of approximately \$830 million, the broadband market of approximately \$630 million and the voice market of approximately \$140 million. Management estimates that over 85% of this market opportunity is from the business and wholesale customer segment.

In response to significant disruptions in the wireless market, primarily related to Verizon's entry into the Alaska market in 2013 and reforms in wireless CETC Revenue for wireless carriers in Alaska, the Company and GCI formed AWN to combine their wireless networks. Following the formation of AWN, the wireless market continued to face competitive pricing pressure from national carriers, and the Company subsequently determined that its wireless business was not economically viable as structured under the AWN arrangement. In the fourth quarter of 2014 we entered into an agreement to sell our retail wireless operations and our interest in AWN to GCI. This transaction was consummated on February 2, 2015. Cash proceeds on the sale of \$285.2 million were utilized to pay down debt by \$240.5 million, fund taxes and other costs associated with the transaction, and fund wind-down costs related to workforce reductions and closing retail stores, as well as general corporate purposes.

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The wind-down activities were essentially completed in 2015 and our cost structure in 2016 reflected the benefit of avoided costs and synergies associated with the exit from the wireless business and our position as a smaller, more focused broadband and managed IT company.

Our objective is to continue generating sector leading revenue growth in the broadband market through investments in sales, service, marketing and product development while expanding our broadband network capabilities. We also intend to grow our managed IT services market by providing these services to our broadband customers, and are positioning the Company to become the premier Cloud Enabler for business in the state of Alaska. We also seek to continuously improve our customer service, and we use the Net Promoter Score ( NPS ) framework to track the feedback of our customers for virtually all customer interactions. We believe that higher NPS scores will allow us to increasingly provide a differentiated service experience for our customers, which will support our growth. We are focused on expanding our margins, and we utilize the LEAN framework to eliminate waste and simplify how we do business.

On April 2, 2015, we entered into an agreement to purchase a terrestrial fiber network on the North Slope of Alaska. This network allows us to provide broadband solutions to the oil and gas sector in a market that previously had no competition, and continue to advance our sales of managed IT services. Also on April 2, 2015, the Company entered into a joint venture agreement with Quintillion for the purpose of expanding the fiber optic network, and making the network available to other telecom carriers. The joint venture may also participate in and facilitate other capital and service initiatives in the telecom industry. We may also participate with Quintillion in acquiring capacity on other parts of the system they are building in Alaska. The contribution from this investment was not material in 2015 and 2016 as we are focused on operationalizing the network to meet our service level standards.

On March 13, 2017, we entered into the 2017 Senior Credit Facility consisting of a Term A-1 Facility of \$120.0 million, a Term A-2 Facility of \$60.0 million and a Revolving Facility of \$15.0 million. Upon the satisfaction of certain conditions, on or before March 28, 2017, we will utilize proceeds from the 2017 Senior Credit Facility and cash on hand to repay in full our 2015 Senior Credit Facilities, including accrued interest and fees, of approximately \$87.8 million, fund the tender of our 6.25% Notes in the amount of \$94.0 million as described below and fund fees and expenses associated with this transaction. This refinancing transaction will result in the extension of scheduled principal payments under our senior credit agreements from 2018 out through 2023.

Pursuant to the 2017 Senior Credit Facility, we intend to commence a tender offer for our outstanding 6.25% Convertible Notes due 2018. The offer will commence upon the filing of Schedule TO with the Securities and Exchange Commission. The outstanding principal balance of the 6.25% Notes was \$94.0 million at December 31, 2016.

On March 13, 2017, we announced that our Board of Directors authorized a stock repurchase program for the Company to repurchase up to \$10.0 million of its Common Stock through December 2019.

## **Business Plan Core Principles**

Our results of operations, financial position and sources and uses of cash in the current and future periods reflect our focus on being the most successful broadband solutions company in Alaska by delivering the best customer experience in the markets we choose to serve. To do this we will continue to:



**Create a Workplace That Develops Our People and Celebrates Success.** We believe an engaged workforce is critical to our success. We are deeply committed to the development of our people and creating opportunities for them.

**Create a Consistent Customer Experience Every Time.** We strive to deliver service as promised to our customers, and make it right if our customers are not satisfied with what we delivered. We track virtually every customer interaction and we utilize the Net Promoter Score framework for assessing the satisfaction of our customers.

**Relentlessly Simplify How We Do Business.** We believe we must reduce waste, which is defined as any activity that does not add value to its intended customer. Doing so improves the experience we deliver to our customers. We make investments in technology and process improvement, utilize the LEAN framework, and expect these efforts to meaningfully impact our financial performance in the long-term.

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**Offer Broadband Solutions to Our Customers at Work and Home.** We are building on strength in designing, building and operating quality broadband networks and providing new products and solutions to our customers.

We believe we can create value for our shareholders by:

Driving revenue growth through increasing business broadband and managed IT service revenues,

Generating Adjusted EBITDA and Adjusted Free Cash Flow growth through margin management, and

Careful allocation of capital, including selectively investing success based capital into opportunities that generate appropriate returns on investments.

**2017 Operating Initiatives**

Business and Wholesale revenue growth driven by new customers, including those utilizing the North Slope fiber network.

Continued expansion of managed IT services, including increased product offerings to existing customers.

Consumer revenue growth driven by sustained broadband additions at 10Mb and above and new product offerings.

Manage cost structure growth by effective allocation of resources, and managing labor and healthcare costs.

Effectively manage capital spending, focusing on customer opportunities, strategic initiatives, maintenance and utilization of funding received through CAF II support.

Continue improving the service experience to all of our customers in a differentiated manner from our competition.

Drive continued improvements in our service delivery organization to shorten service intervals and meet customers' desired due dates.

Consider strategic opportunities in and out of Alaska that address scale and geographic diversification and reduce the risk of investments made in our company.

Continue our deployment of broadband solutions such as hosted VoIP and VPLS, and take advantage of our Metro Ethernet Forum designation.

Continue building strategic customer relationships, including with anchor tenant type customers.

### **Revenue Sources by Customer Group**

We manage our revenues based on the sale of services and products to the three wireline customer categories listed below. Prior to the Wireless Sale in the first quarter of 2015 we also provided retail wireless services and generated certain revenue streams related to our ownership in AWN.

#### **Business and Wholesale (broadband, voice and managed IT services)**

#### **Consumer (broadband and voice services)**

#### **Regulatory (access charges, surcharges and federal and state support)**

#### **Business and Wholesale**

Providing services to Business and wholesale customers provides the majority of our revenues and is expected to continue being the primary driver of our growth over the next few years. Our business customers include large enterprises, government customers and small and medium business. We were the first Alaska-based carrier to be Carrier Ethernet 2.0 Certified and are currently the only Alaska-based carrier certified for multipoint-to-multipoint service. This certification means that we meet international standards for the quality of our broadband services. We also offer IP based voice including the largest

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SIP implementations in the state of Alaska, and are the first Microsoft Express Route provider in the state. We believe our network differentiates us in the markets we serve, because we prefer not to compete on price; but on the quality, reliability and the overall value of our solutions. Accordingly, we have significant capacity to sell into the network we operate and do so at what we believe are attractive incremental gross margins.

Business services have experienced significant growth and we believe the incremental economics of business services are attractive. Given the demand from our customers for more bandwidth and services, we expect revenue growth from these customers to continue for the foreseeable future. We provide services such as voice and broadband, managed IT services including remote network monitoring and support, managed IT security and IT professional services, and long distance services primarily over our own terrestrial network. We are also positioning the Company to become the premier Cloud Enabler for business in the state of Alaska.

Our wholesale customers are primarily national and international telecommunications carriers who rely on us to provide connectivity for broadband and other needs to access their customers over our Alaskan network. The wholesale market is characterized by larger transactions that can create variability in our operating performance. We have a dedicated sales team that sells into this customer segment, and we expect wholesale revenue to grow for the foreseeable future.

## **Consumer**

We provide voice and broadband services to residential customers. Given that our primary competitor has extensive quad play capabilities (video, voice, wireless and broadband) we target how and where we offer products and services to this customer group in order to maintain our returns. Our focus is to leverage the capabilities of our existing network and sell customers our highest available bandwidth. Our primary competitive advantage is that we offer reliable internet service without data caps, while our competitor charges customers or throttles customers speeds for exceeding given levels of data usage. Revenues from these customers began to stabilize in the second half of 2016 and we expect modest growth beginning in 2017.

## **Regulatory**

Regulatory revenue is generated from three primary sources: (i) Access charges, which include interstate and intrastate switched access and special access charges, and cellular access; (ii) Surcharges billed to the end user (pass-through and non-pass-through); and (iii) federal and state support. We provide voice and broadband origination and termination services to interstate and intrastate carriers. While we are compensated for these services, these revenue streams have been in decline and we expect them to continue to decline. In addition, as regulators have reformed traditional access charges, they have simultaneously implemented new end user surcharges that contribute to our revenue.

### *Access Charges*

Interstate and intrastate switched access are services based primarily on originating and terminating access minutes from other carriers. Special access is primarily access to dedicated circuits sold to wholesale customers, substantially all of which is generated from interstate services. Cellular access is the transport of tariffed local network services between switches for cellular companies based on individually negotiated contracts. For the years ended December 31, 2016, 2015 and 2014, access charges represented approximately 2.5%, 2.8% and 3.2%, respectively, of our total wireline revenue.

### *Surcharges*

We assess our customers for surcharges, typically on a monthly basis, as required by various state and federal regulatory agencies, and remit these surcharges to these agencies. These pass-through surcharges include Federal Universal Access and State Universal Access. These surcharges vary from year to year, and are primarily recognized as revenue, and the subsequent remittance to the state or federal agency as a cost of sale and service. The rates imposed by the regulators continue to increase. However, because the charges are only assessed on a portion of our services, and that portion continues to decline, we expect these revenue streams to decline over time as the revenue base declines. Other non-pass-through surcharges are collected from our customers as authorized by the regulatory body. The amount charged is based on the type of line: single line business, multi-line business, consumer or

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lifeline. The rates are established based on federal or state orders. These charges are recorded as revenue and do not have a direct associated cost. Rather, they represent a revenue recovery mechanism established by the FCC or the Regulatory Commission of Alaska. For the years ended December 31, 2016, 2015 and 2014, pass-through surcharges represented approximately 32%, 30% and 28%, respectively, of the total surcharge revenue billed to our end customers.

### *Federal and State Support*

We receive interstate and intrastate universal support funds and similar revenue streams structured by federal and state regulatory agencies that allow us to recover our cost of providing universal service in Alaska. For the year ending December, 31, 2016 the Company recognized \$19.7 million in federal high cost universal service revenues to support our wireline operations in high cost areas. The FCC has released the CAF Phase II order specific to Alaska Communications which transitioned from CAF Phase I frozen support to CAF Phase II. Funding under the new program will generally require the Company to provide broadband service to unserved locations throughout the designated coverage area by the end of a specified build-out period, and meet interim milestone build-out obligations. In addition to federal high cost support, the Company is designated by the State of Alaska as a COLR in five of the six study areas. In addition to COLR, the Company receives CCL support. We do not receive COLR or CCL funding for the ACS of Anchorage study area. As a COLR we are required to provide services essential for retail and carrier-to-carrier telecommunication throughout the applicable coverage area. For the years ended December 31, 2016, 2015 and 2014, total federal and state support represented approximately 11%, 12% and 13%, respectively, of total wireline revenue.

### *Wireless & AWN Related Revenue*

Prior to the Wireless Sale in the first quarter of 2015, we provided wireless voice and broadband services, and other value-added wireless products and services, such as wireless devices, across Alaska with roaming coverage available in the contiguous states, Hawaii and Canada by utilizing the AWN network.

Because our network provides access to the retail marketplace, and as a result of the cost of providing service to high cost areas, we generated CETC revenues established by either state or federal regulatory agencies. As part of the AWN Formation, we agreed to pay a service charge to AWN for an amount equal to our CETC Revenue, and therefore CETC Revenue had no impact on our net income (loss) or Adjusted EBITDA calculations.

Prior to the AWN Formation, we also provided backhaul services to other wireless carriers. Backhaul services are broadband connections between a wireless carrier's cell site, their central office switch and connectivity to the Internet. Upon the AWN Formation, all existing backhaul contracts were transferred to AWN. However, we were not excluded from providing backhaul services in the future, and now compete for these services. We have since added wireless backhaul contracts, and expect to continue to vigorously compete for and grow these revenues.

Following the Wireless Sale, we were required to provide transition services to GCI, which required us to continue to maintain certain aspects of our retail wireless operations, such as the operation of our retail stores, maintaining wireless retail customer support functions in our contact center and providing certain supply chain management, billing and collection and treasury management functions. These transition services were completed on April 17, 2015.

## **Executive Summary**

The following summary should be read in conjunction with Non-GAAP Financial Measures included in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

***Operating Revenues***

Total revenue of \$226.9 million in 2016 was generally in line with our expectations and compares with \$232.8 million in 2015. Total wireline revenue of \$226.9 million increased \$7.1 million, or 3.2%, from \$219.8 million in 2015.

Business and wholesale revenue of \$136.9 million increased \$10.4 million, or 8.2%, driven by broadband growth totaling \$11.6 million, or 14.7%. Consumer and regulatory revenue declined \$2.3 million and \$1.1 million, respectively. Wireless and AWN related revenue, including transition services revenue, was \$13.0 million in 2015. The sale of our Wireless operations was completed in the first quarter of 2015 and no wireless revenues were recorded subsequent to the second quarter of 2015.

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### **Operating Income**

Operating income of \$19.5 million in 2016 compares with \$47.7 million in 2015. The gain of \$48.2 million recorded on the Wireless Sale and earnings of \$3.1 million from the equity investment in AWN in 2015 were offset by the avoidance of storefront exit, severance, wind-down and transaction costs totaling \$13.3 million recorded in 2015 and lower operating expenses in 2016. These items are discussed in more detail below.

### **Adjusted EBITDA**

Adjusted EBITDA of \$58.2 million in 2016 increased \$8.3 million, or 16.6%, from \$49.9 in 2015 due primarily to the growth in Business and wholesale revenue and our improved cost structure following the sale and wind-down of our wireless operations in 2015. See **Non-GAAP Financial Measures** for the definition of Adjusted EBITDA and a reconciliation of Adjusted EBITDA to Net Income.

### **Operating Metrics**

Business broadband average monthly revenue per user ( **ARPU** ) of \$337.98 in the fourth quarter of 2016 increased from \$299.10 in the fourth quarter of 2015 and increased to \$322.80 for the year in 2016 from \$272.37 in 2015. Business broadband connections of 15,239 at December 31, 2016, were down marginally from connections of 15,340 at December 31, 2015. We count connections on a unitary basis regardless of the size of the bandwidth. For example, a customer that has a 10MB connection is counted as one connection as is a customer with a 1MB connection. While we present metrics related to Business connections, we note that we manage Business and wholesale in terms of new Monthly Recurring Charges ( **MRC** ) sold. Achievement of sales performance in terms of MRC is the primary operating metric used by management to measure market performance. For competitive reasons we do not disclose our sales or performance in MRC.

Consumer broadband connections of 34,603 were up 4.0% year over year due to growth in home internet subscribers. Consumer broadband ARPU of \$60.73 in 2016 decreased from \$61.32 in 2015 as a result of customers moving to the Company's one price, unlimited home internet package beginning in the third quarter of 2015, partially offset by customers subscribing to higher levels of bandwidth speeds.



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The table below provides certain key operating metrics as of, or for, the periods indicated.

	2016	2015
<b>Voice</b>		
At December 31:		
Business access lines	73,977	76,598
Consumer access lines	33,418	37,683
For the year ended December 31:		
Voice ARPU business	\$ 23.45	\$ 23.40
Voice ARPU consumer	\$ 28.71	\$ 27.65
<b>Broadband</b>		
At December 31:		
Business connections	15,239	15,340
Consumer connections	34,603	33,275
For the year ended December 31:		
ARPU business	\$ 322.80	\$ 272.37
ARPU consumer	\$ 60.73	\$ 61.32

**Liquidity**

We generated cash from operating activities of \$37.3 million in 2016 compared with \$12.6 million in 2015. This increase primarily reflects our improved cost structure and lower payments for Wireless Sale transaction and wind-down costs, interest and taxes, partially offset by cash distributions received from AWN in 2015.

In 2016, we invested a total of \$40.3 million of cash in capital, including capitalized interest and the settlement of items accrued in previous periods, and repurchased a portion of our 6.25% Notes in the principal amount of \$10.0 million at a 2.5% discount.

Net debt (defined as total debt excluding debt issuance costs and discounts, less cash and cash equivalents) at December 31, 2016 was \$162.8 million compared with \$161.7 million at December 31, 2015.

As described above, we announced on March 13, 2017 our refinancing transaction, which will result in the extension of scheduled principal payments on our credit agreements from 2018 out through 2023, and the forthcoming tender offer on our 6.25% Notes.

**Other Initiatives**

During 2016 we expanded our product and service offering, including our cloud enablement partnerships and investment in our Anchorage-based Business Technology Center.

We recently entered into capacity agreements that will open new markets in North West Alaska, providing another driver of future growth.

**Table of Contents****RESULTS OF OPERATIONS**

The following tables summarize our results of operations for the years ended December 31, 2016, 2015 and 2014. Revenue information reflects the organization of revenue streams described in Revenue Sources by Customer Group above. Revenues for 2015 and 2014 have been reclassified to conform to the 2016 presentation. The reclassifications include (i) assigning equipment sales and installations to Business and wholesale and Consumer (included in voice and other ); and (ii) establishment of a Regulatory revenue category. All amounts are discussed at the consolidated level after the elimination of affiliate revenue and expense. Results in 2015 reflect the sale and wind-down of our Wireless operations beginning in the first quarter. Results in 2014 reflect the first full year of operations under the AWN structure, which included the movement of roaming and backhaul revenue to AWN.

(in thousands)	2016	2015	2014
<b>Business and Wholesale Revenue</b>			
Business broadband	\$ 59,218	\$ 51,058	\$ 44,461
Business voice and other	27,903	28,909	28,827
Managed IT services	4,173	3,316	3,492
Equipment sales and installations	6,441	6,274	5,195
Wholesale broadband	31,581	28,126	23,216
Wholesale voice and other	7,539	8,764	9,925
<b>Business and Wholesale Revenue</b>	<b>136,855</b>	<b>126,447</b>	<b>115,116</b>
<i>Growth in Business and Wholesale Revenue</i>	<i>8.2%</i>	<i>9.8%</i>	
<b>Consumer revenue</b>			
Broadband	24,981	25,621	25,689
Voice and other	12,763	14,408	15,773
<b>Consumer Revenue</b>	<b>37,744</b>	<b>40,029</b>	<b>41,462</b>
<b>Total Business, Wholesale, and Consumer Revenue</b>	<b>174,599</b>	<b>166,476</b>	<b>156,578</b>
<i>Growth in Business, Wholesale and Consumer Revenue</i>	<i>4.9%</i>	<i>6.3%</i>	
<i>Growth in Broadband Revenue</i>	<i>10.5%</i>	<i>12.3%</i>	
<b>Regulatory Revenue</b>			
Access	32,412	33,644	35,323
High cost support	19,855	19,682	23,192
<b>Total Regulatory Revenue</b>	<b>52,267</b>	<b>53,326</b>	<b>58,515</b>
<b>Total Wireline Revenue</b>	<b>226,866</b>	<b>219,802</b>	<b>215,093</b>
<i>Growth in Wireline Revenue</i>	<i>3.2%</i>	<i>2.2%</i>	
<b>Total Wireless &amp; AWN Related Revenue</b>		<b>13,015</b>	<b>99,770</b>
<b>Total Revenue</b>	<b>\$ 226,866</b>	<b>\$ 232,817</b>	<b>\$ 314,863</b>



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	2016	2015	2014
Operating expenses:			
Cost of services and sale (excluding depreciation and amortization), non-affiliates	102,137	107,162	123,854
Cost of services and sale (excluding depreciation and amortization), affiliates		4,961	57,116
Selling, general and administrative	70,209	88,389	101,398
Depreciation and amortization	34,690	33,867	32,583
Loss (gain) on disposal of assets, net	321	(46,252)	126
Loss on impairment of goodwill			5,986
Earnings from equity method investments		(3,056)	(35,960)
Total operating expenses	207,357	185,071	285,103
Operating income	19,509	47,746	29,760
Other income and (expense):			
Interest expense	(15,447)	(19,841)	(34,410)
Loss on extinguishment of debt	(336)	(4,878)	
Interest income	26	58	83
Total other income and (expense)	(15,757)	(24,661)	(34,327)
Income (loss) before income tax (expense) benefit	3,752	23,085	(4,567)
Income tax (expense) benefit	(1,499)	(10,200)	1,787
Net income (loss)	2,253	12,885	(2,780)
Less net loss attributable to noncontrolling interest	(133)	(69)	
Net income (loss) attributable to Alaska Communications	\$ 2,386	\$ 12,954	\$ (2,780)

**Year Ended December 31, 2016 Compared to the Year Ended December 31, 2015****Operating Revenue****Business and Wholesale**

Business and wholesale revenue of \$136.8 million increased \$10.4 million, or 8.2%, in 2016 from \$126.4 million in 2015. This improvement was primarily driven by an \$8.2 million increase from new and existing customers buying or increasing their consumption of bandwidth using our advanced network services such as MPLS, dedicated Internet and Enhanced Metro Ethernet. Although business broadband connections of 15,239 in 2016 declined marginally from 15,340 in 2015, business broadband ARPU drove overall revenue growth and reflects customer demand for increasing amounts of bandwidth. Business broadband ARPU increased to \$322.80 in 2016 from \$272.37 in 2015, or 18.5%. Wholesale broadband revenue increased \$3.5 million and Managed IT services revenue increased \$0.9 million year over year. These increases were partially offset by a \$2.2 million total decrease in voice and other revenue due primarily to 4,394 fewer business and wholesale voice connections year over year. Business voice ARPU of \$23.45 in

2016 increased marginally compared with \$23.40 in 2015. While connections and ARPU serve as data points to support the analysis of period-over-period changes in revenue, they are not critical indicators utilized by the Company to manage the Business and Wholesale customer group.

*Consumer*

Consumer revenue of \$37.7 million decreased \$2.3 million, or 5.7%, in 2016 from \$40.0 million in 2015. Broadband revenue decreased \$0.6 million to \$25.0 million in 2016 from \$25.6 million in 2015 due to a decrease in ARPU from \$61.32 to \$60.73, largely offset by a 1,328 increase in connections year over year. The effect of customers subscribing to higher levels of bandwidth speeds was partially offset by the effect of

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customers moving to the Company's one price, unlimited home internet package beginning in the third quarter of 2015. Voice and other revenue decreased \$1.6 million primarily due to 4,265 fewer connections, partially offset by an increase in ARPU to \$28.71 from \$27.65 in the prior year. The downward trend in voice connections is expected to continue as more customers discontinue using their fixed landline voice service and move to wireless alternatives.

### *Regulatory*

Regulatory revenue of \$52.3 million decreased \$1.0 million, or 2.0%, in 2016 from \$53.3 million in 2015 due to a \$1.2 million decline in access revenue caused primarily by lower eligible access lines combined with lower rates, partially offset by a one-time \$0.2 million increase in high cost support.

### *Wireless and AWN Related*

Wireless and AWN related revenue of \$13.0 million in 2015 included service, equipment sales and other revenue of \$6.3 million, transition services revenue of \$4.8 million associated with the Company providing certain retail services to its previous wireless customers for an interim period following the sale, and CETC revenue of \$1.7 million. The Company recorded no Wireless and AWN related revenue in 2016 as a result of the sale of its wireless operations effective February 2, 2015 and subsequent wind-down during 2015.

### ***Operating Expenses***

#### *Cost of Services and Sales (excluding depreciation and amortization), Non-Affiliates*

Cost of services and sales (excluding depreciation and amortization), non-affiliates of \$102.1 million decreased \$5.1 million, or 4.7%, in 2016 from \$107.2 million in 2015. This decrease reflects storefront exit and other wind-down costs of \$4.9 million recorded in 2015 associated with the sale of our wireless operations, a \$1.7 million reduction in labor costs resulting from our new cost structure and the avoidance of \$1.2 million of wireless device and accessory costs recorded in 2015. These items were partially offset by a \$2.1 million increase in circuit installation costs for new customers recorded in 2016.

#### *Cost of Services and Sales (excluding depreciation and amortization), Affiliates*

Cost of services and sales (excluding depreciation and amortization), affiliates were zero in 2016 compared with \$5.0 million in 2015 due to the sale of our wireless operations and the discontinuance of the associated affiliate transactions.

#### *Selling, General and Administrative*

Selling, general and administrative expenses of \$70.2 million decreased \$18.2 million, or 20.6%, in 2016 from \$88.4 million in 2015. This decrease reflects severance, transaction and other wind-down costs of \$8.4 million recorded in 2015 associated with the sale of our wireless operations, a \$7.4 million reduction in salaries and benefits resulting from our new cost structure and a \$1.3 million reduction in bad debt expense associated primarily with non-recurring reserves in 2015 for certain rural health care accounts.

#### *Depreciation and Amortization*

Depreciation and amortization expense of \$34.7 million increased \$0.8 million, or 2.4%, in 2016 from \$33.9 million in 2015. Increases resulting from assets recently placed in service, including those associated with projects on the

North Slope of Alaska and our joint venture with Quintillion Holdings, LLC ( QHL ), were largely offset by the sale of wireless assets in 2015.

*Loss (Gain) on Disposal of Assets, Net*

The net loss on the disposal of assets of \$0.3 million in 2016 was associated with cancelled capital projects. The net gain on the disposal of assets of \$46.3 million in 2015 reflected the \$48.2 million gain on the sale of our wireless operations on February 2, 2015, partially offset by losses of \$1.0 million associated with abandoned projects and \$1.0 million in wireless asset retirements.

*Earnings from Equity Method Investments*

Earnings from equity method investments were zero in 2016 and \$3.1 million in 2015, consisting entirely of the Company's share of the earnings of AWN. The year over year decline reflects the Company's sale of its wireless operations, including its investment in AWN, in the first quarter of 2015.

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***Other Income and Expense***

Interest expense of \$15.4 million in 2016 decreased \$4.4 million compared with \$19.8 million in 2015. This decrease was due primarily to lower outstanding debt year over year resulting from the pay down of \$240.5 million of our 2010 Senior Credit Facility in February of 2015 and, to a lesser extent, the effect of our 2015 refinancing transactions completed on September 14, 2015 and repurchase of a portion of our 6.25% Notes in January 2016 and September 2015. The \$0.3 million loss on extinguishment of debt in 2016 was associated with the repurchase of our 6.25% Notes in the principal amount of \$10.0 million. The \$4.9 million loss on extinguishment of debt in 2015 consisted of \$3.9 million associated with the pay down and subsequent repayment in full of our 2010 Senior Credit Facility and \$0.9 million associated with the purchase of a portion of our 6.25% Notes in connection with our 2015 refinancing transactions.

***Income Taxes***

Income tax expense and the effective tax rate in 2016 were \$1.5 million and 40.0%, respectively, and consisted of Federal tax of \$1.3 million at the statutory rate of 35.0% and state tax, net of the Federal benefit, of \$0.2 million, or 6.1%. The income tax provision also reflected a \$0.3 million net benefit for the realization of certain state net operating loss carryforwards upon the filing of the 2015 return, partially offset by the establishment of valuation allowances totaling \$0.1 million on net operating loss carryforwards for other states. Excluding these discrete items, the Company's effective tax rate was approximately 46% in 2016. Income tax expense and the effective tax rate in 2015 were \$10.2 million and 44.2%, respectively, and consisted primarily of Federal tax of \$8.1 million at the statutory rate of 35.0% and state tax, net of the Federal benefit, of \$1.4 million, or 6.1%. The effective rate in 2015 also reflected 1.9%, or \$0.4 million, associated with unrealized amortization of stock compensation.

***Net Loss Attributable to Noncontrolling Interest***

The net loss attributable to the noncontrolling interest of our joint venture with QHL, which was established during the second quarter of 2015, was \$133 thousand and \$69 thousand in 2016 and 2015, respectively.

***Net Income Attributable to Alaska Communications***

Net income attributable to Alaska Communications of \$2.4 million in 2016 compares with \$13.0 million in 2015. The year over year results reflect the revenue and expense items discussed above.

**Year Ended December 31, 2015 Compared to the Year Ended December 31, 2014**

***Operating Revenue***

***Business and Wholesale***

Business and Wholesale revenue of \$126.4 million increased \$11.3 million, or 9.8%, in 2015 from \$115.1 million in 2014. This improvement was primarily driven by a \$6.6 million increase from new and existing customers buying or increasing their consumption of bandwidth using our advanced network services such as MPLS, dedicated Internet and Enhanced Metro Ethernet. Although broadband connections of 15,340 in 2015 declined from 18,798 in 2014, growth of broadband ARPU drove overall revenue growth and reflects customer demand for increasing amounts of bandwidth. Broadband ARPU increased to \$272.37 in 2015 from \$198.49 in 2014, an increase of 37.2%. Additionally, wholesale broadband revenue increased \$4.9 million related to an increase in carrier circuits, of which \$1.9 million was associated with our new capacity agreement with GCI. Prior to the Wireless Sale, the revenues associated with



this agreement were associated with a related-party agreement with AWN and reported as Wireless and AWN related revenue. Equipment sales and installations increased \$1.1 million. These increases were partially offset by a \$1.3 million total decrease in voice and other revenue due in part to 4,090 fewer business and wholesale voice connections year over year and marginally lower business ARPU of \$23.40 compared with \$23.52 in the prior year reflecting price compression. Managed IT services revenue decreased \$0.2 million. While connections and ARPU serve as data points to support the analysis of period-over-period changes in revenue, they are not critical indicators utilized by the Company to manage the Business and Wholesale customer group.

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### *Consumer*

Consumer revenue of \$40.0 million decreased \$1.4 million, or 3.5%, in 2015 due to a change in composition. Voice revenue decreased \$1.4 million primarily due to 6,090 fewer connections partially offset by a slight increase in ARPU to \$27.65 in 2015 from \$26.68 in 2014. This trend is expected to continue as more customers discontinue using their fixed landline voice service and move to wireless alternatives. Broadband revenue decreased marginally in 2015. Broadband connections decreased 4,137 year over year; however, customers are subscribing to higher levels of bandwidth speeds, which resulted in a 11.4% increase in ARPU to \$61.32 from \$55.04 in the prior year.

### *Regulatory*

Regulatory revenue of \$53.3 million decreased \$5.2 million, or 8.9%, in 2015 from \$58.5 million in 2014 largely due to a non-recurring \$3.5 million release of high cost support reserves in 2014. Additionally, there was a decrease of \$1.7 million in access revenue caused primarily by lower eligible access lines combined with lower rates.

### *Wireless and AWN Related*

The wind-down of our wireless operations effective February 2, 2015 resulted in a \$91.5 million decrease in service revenue, equipment sales, CETC revenue and the reclassification of capacity revenue noted in business and wholesale above. The recognition of transition services revenue of \$4.8 million in 2015 partially offset these declines.

## ***Operating Expenses***

### *Cost of Services and Sales (excluding depreciation and amortization), Non-Affiliates*

Cost of services and sales (excluding depreciation and amortization), non-affiliates of \$107.2 million decreased \$16.7 million, or 13.5%, in 2015 from \$123.9 million in 2014. This decrease was due to a decline of \$16.5 million in wireless device and accessory costs, a decline of \$1.5 million in access expense due to the Wireless Sale, a decrease of \$1.3 million related to maintenance of the wireless CDMA network, a \$0.9 million recovery of certain State regulatory surcharges in 2015, a \$0.4 million reduction in facilities expenses and a \$0.4 million reserve adjustment related to local exchange reimbursable billings. In addition, 2014 results were negatively impacted by \$0.9 million in leased circuit costs, \$0.3 million in submarine repair costs associated with the severed fiber optic cable caused by the July 2014 earthquake, a \$0.6 million write off of held-for-sale wireless inventory marked to fair value less cost to sell and a \$0.4 million write off of obsolete inventory. Partially offsetting these decreases were \$4.9 million in storefront exit and other wind-down costs associated with the sale of our wireless operations and an increase in labor costs of \$1.5 million primarily associated with the acquisition of TekMate, LLC ( TekMate ) in January 2014.

### *Cost of Services and Sales (excluding depreciation and amortization), Affiliates*

Cost of services and sales (excluding depreciation and amortization), affiliates of \$5.0 million decreased \$52.1 million in 2015 from \$57.1 million in 2014. This decrease was due to the sale of our wireless operations on February 2, 2015 and the discontinuance of the associated affiliate transactions.

### *Selling, General and Administrative*

Selling, general and administrative expenses of \$88.4 million decreased \$13.0 million, or 12.8%, in 2015 from \$101.4 million in 2014. This decrease was driven by a \$7.2 million reduction in customer service costs and a \$3.2 million decrease in wireless agent commission, billing costs and property taxes as a result of the Wireless Sale. In

addition, other labor costs declined \$2.6 million, advertising, legal and other administrative costs declined \$1.8 million, bad debt expense decreased \$1.5 million due to certain recoveries on rural health care customers and incentive based compensation expense decreased \$0.9 year over year. These decreases were partially offset by \$8.4 million in severance, transaction and other wind-down costs associated with the sale of our wireless operations recorded in 2015 compared with \$4.3 million recorded in 2014.

*Depreciation and Amortization*

Depreciation and amortization expense of \$33.9 million increased \$1.3 million, or 3.9%, in 2015 from \$32.6 million in 2014. Depreciation was relatively flat due to the offsetting impact of higher depreciation on assets recently placed in service and a decline in depreciation due to assets sold in connection with the Wireless Sale.

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*Loss (Gain) on Disposal of Assets, Net*

The net gain on the disposal of assets of \$46.3 million in 2015 reflected the \$48.2 million gain on the sale of our wireless operations on February 2, 2015, partially offset by losses of \$1.0 million associated with abandoned projects and \$1.0 million in wireless asset retirements. The loss of \$0.1 million in 2014 was primarily associated with \$0.3 million related to projects and maintenance that moved to AWN, partially offset by a land sale and excess removal obligations on terminated leases.

*Loss on Impairment of Goodwill*

The loss on impairment of goodwill of \$6.0 million in 2014 was due to the Company's assessment of goodwill after the announcement of Wireless Sale transaction.

*Earnings from Equity Method Investments*

Earnings from equity method investments of \$3.1 million in 2015 and \$36.0 million in 2014 consist entirely of the Company's share of the earnings of AWN. The year over year decline reflects the Company's sale of its wireless operations, including its investment in AWN, in the first quarter of 2015.

*Other Income and Expense*

Interest expense of \$19.8 million in 2015 decreased \$14.6 million compared with \$34.4 million in 2014 due primarily to lower outstanding debt year over year associated with the pay down of our 2010 Senior Credit Facility on February 2, 2015 and, to a lesser extent, the effect of our 2015 refinancing transactions completed on September 14, 2015. This decrease was partially offset by the reclassification of over hedged swaps to interest expense in 2015 in connection with the pay down of our 2010 Senior Credit Facility on February 2, 2015. The \$4.9 million loss on extinguishment of debt in 2015 consisted of \$3.9 million associated with the pay down and subsequent repayment in full of our 2010 Senior Credit Facility and \$0.9 million associated with the purchase of a portion of our 6.25% Notes in connection with our 2015 refinancing transactions.

*Income Taxes*

Income tax expense and the effective tax rate in 2015 were \$10.2 million and 44.2%, respectively, and consisted primarily of Federal tax of \$8.1 million at the statutory rate of 35.0% and state tax, net of the Federal benefit, of \$1.4 million, or 6.1%. The effective rate in 2015 also reflected 1.9%, or \$0.4 million, associated with unrealized amortization of stock compensation. Income tax expense and the effective tax rate in 2014 were \$1.8 million and 39.1%, respectively, and consisted primarily of Federal tax of \$1.6 million at the statutory rate of 35.0% and state tax, net of the Federal benefit, of \$0.3 million, or 6.1%.

*Net Loss Attributable to Noncontrolling Interest*

The net loss attributable to the noncontrolling interest of our joint venture with QHL, which was established during the second quarter of 2015, was \$69 thousand in 2015.

**Table of Contents*****Net Income (Loss) Attributable to Alaska Communications***

Net income attributable to Alaska Communications of \$13.0 million in 2015 compares with a net loss of \$2.8 million in 2014. The year over year results reflect the revenue and expense items discussed above.

**FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES****Cash Flows**

We satisfied our cash requirements for operations, capital expenditures, and debt service and repurchases in 2016, 2015 and 2014 primarily through internally generated funds, cash on hand, distributions from AWN and our refinancing initiative in the third quarter of 2015. We also received cash proceeds of \$285.2 million on the Wireless Sale in 2015 which we used primarily to pay down debt. At December 31, 2016, we had \$21.2 million in cash and cash equivalents, \$1.9 million in restricted cash and a \$10.0 million undrawn revolving credit facility.

A summary of significant sources and use of funds for the years ended December 31, 2016, 2015 and 2014 is as follows:

(in thousands)	2016	2015	2014
Net cash provided by operating activities	\$ 37,253	\$ 12,581	\$ 51,169
Capital expenditures	\$ (30,920)	\$ (50,914)	\$ (46,423)
Capitalized interest	\$ (1,077)	\$ (1,558)	\$ (2,810)
Change in unsettled capital expenditures	\$ (8,304)	\$ 3,995	\$ (2,003)
Proceeds on wireless sale	\$	\$ 285,160	\$
Proceeds on sale of assets	\$ 2,664	\$ 3,140	\$ 136
Return of capital from equity investment	\$	\$ 1,875	\$ 14,073
Net change in restricted cash	\$ (93)	\$ (1,357)	\$
Repayments of long-term debt	\$ (13,421)	\$ (333,961)	\$ (24,419)
Proceeds from the issuance of long-term debt	\$	\$ 90,061	\$
Debt issuance costs	\$ (544)	\$ (4,901)	\$
Interest paid	\$ 12,608	\$ 16,101	\$ 31,562
Income taxes paid, net	\$ 205	\$ 4,936	\$ 260

***Cash Flows from Operating Activities***

Cash provided by operating activities of \$37.3 million in 2016 compares with \$12.6 million in 2015. The year over year increase was primarily due to lower payments for Wireless Sale transaction and wind-down costs, our improved cost structure and lower payments for interest and taxes, partially offset by cash distributions received from AWN in 2015. Wireless Sale transaction and wind-down payments were \$1.1 million and \$10.0 million in 2016 and 2015, respectively.

Cash provided by operating activities of \$37.3 million in 2016 reflects net income excluding non-cash items (defined as cash provided by operating activities excluding cash distributions from equity method investments and changes in income taxes receivable/payable and operating assets and liabilities) of \$43.9 million offset by a \$4.8 million decrease in accounts payable other current liabilities reflecting incentive compensation, interest and Wireless Sale wind-down payments.

Cash provided by operating activities of \$12.6 million in 2015 reflected net income excluding non-cash items of \$13.7 million, a \$6.3 million decrease in accounts receivable and other current assets, a \$3.8 million increase in deferred revenue, cash payments from AWN representing a return on capital of \$3.1 million and a \$1.6 million decrease in materials and supplies. These items were partially offset by a \$15.4 million reduction in accounts payable and other current liabilities excluding capital items. This decrease included Wireless Sale, interest and incentive compensation payments.

Cash provided by operating activities of \$51.2 million in 2014 reflected net income excluding non-cash items of \$6.8 million, cash payments from AWN representing a return on capital of \$36.0 million, a \$4.1 million increase in accounts payable and other current liabilities excluding capital items, a \$3.9 million decrease in materials and supplies and a \$6.4 million increase in deferred revenue associated with a large customer contract. These items were partially offset by a \$6.1 million increase in accounts receivable.

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Interest payments, net of cash interest income and including capitalized interest, were \$12.6 million, \$16.1 million and \$31.6 million in 2016, 2015 and 2014, respectively. Through an interest rate swap entered into on November 27, 2015, interest on approximately 50% of the term loan components of our 2015 Senior Credit Facilities at December 31, 2016 is substantially fixed at an annual rate of 5.833% for the period December 2016 through December 2017. Our \$120.0 million convertible debt has a fixed coupon rate of 6.25% and an outstanding balance of \$94.0 million at December 31, 2016. We purchased additional convertible debt in the principal amount of \$10.0 million in 2016.

***Cash Flows from Investing Activities***

Cash used by investing activities of \$37.7 million in 2016 consisted primarily of expenditures on capital (capital expenditures including capitalized interest and net of change in unsettled capital expenditures) totaling \$40.3 million including the second \$5.5 million payment for the purchase of the Fiber Optic System in 2015. Of \$30.9 million incurred in 2016, \$15.5 million was success based versus maintenance. Proceeds on the sale of assets included receipt of the second payment of \$2.7 million for the fiber strands sold to QHL in 2015.

Cash provided by investing activities of \$240.3 million in 2015 included proceeds on the Wireless Sale of \$285.2 million. Proceeds from investing activities also included \$1.9 million of cash distributions from AWN representing a return of capital and \$3.1 million on the sale of assets, primarily associated with the sale of fiber on the North Slope fiber optic network. Total capital spending was \$48.5 million, including \$5.5 million for purchase of the fiber optic network and \$6.7 million associated with spend incurred in a prior period. Of the \$50.9 million incurred in 2015, \$11.0 million was for the fiber optic network (\$5.5 million of which was payable in 2016) and an additional \$18.8 million was success based versus maintenance.

Cash used by investing activities of \$37.0 million in 2014 consisted of capital expenditures totaling \$51.2 million, partially offset by a \$14.1 million return of capital on our equity investment in AWN.

Our networks require the timely maintenance of plant and infrastructure. Future capital requirements may change due to impacts of regulatory decisions that affect our ability to recover our investments, changes in technology, the effects of competition, changes in our business strategy, and our decision to pursue specific acquisition and investment opportunities. We intend to fund future capital expenditures with cash on hand and net cash generated from operations.

***Cash Flows from Financing Activities***

Cash used by financing activities of \$14.3 million in 2016 consisted primarily of the repurchase of \$10.0 million principal amount of our 6.25% Notes for \$9.8 million and scheduled principal payments on the First Lien Term Loan of our 2015 Senior Credit facilities totaling \$3.0 million.

In September of 2015, we entered into the 2015 Senior Credit Facilities, which consisted of a combined \$100.0 million of senior secured financing, including term loans totaling \$90.0 million and a \$10.0 million revolving credit facility. We used proceeds from the 2015 Senior Credit Facilities and cash on hand to repay in full our 2010 Senior Credit Facility, including accrued interest and fees, of \$81.5 million, purchase a portion of our 6.25% Notes in the principal amount of \$10.0 million for cancellation and fund transaction fees and expenses associated with the 2015 Senior Credit Facilities totaling \$3.9 million.

Cash used by financing activities of \$248.6 million in 2015 consisted primarily of repayments of long term debt totaling \$334.0 million partially offset by proceeds from the issuance of debt totaling \$90.1 million. Repayment of

long term debt included \$240.5 million paid on our 2010 Senior Credit Facility from proceeds on the Wireless Sale and, in connection with our third quarter refinancing activities, repayment of the balance of the 2010 Senior Credit Facility in the amount of \$80.4 million and purchase of our 6.25% Notes in the principal amount of \$10.0 million. Proceeds from the 2015 Senior Credit Facilities totaling \$90.1 million were used in part to repay our 2010 Senior Credit facility and purchase a portion of our 6.25% Notes. We incurred debt issuance costs of \$4.9 million primarily associated with the 2015 Senior Credit Facilities and the amendment to our 2010 Senior Credit Facility. We also made a final contingent payment of \$0.3 million in connection with our acquisition of TekMate. Cash proceeds from financing activities included a \$0.3 million contribution to our joint venture with Quintillion Holdings, LLC by the noncontrolling interest and \$0.3 million of proceeds from the issuance of common stock.



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Cash used in financing activities was \$25.5 million in 2014 relating almost exclusively to the pay-down of \$24.4 million in debt.

The payment of cash dividends is not permitted under the terms of our 2015 Senior Credit Facilities until such time that the Company's net total leverage ratio (as defined in that agreement) is not greater than 2.75 to 1.00.

## **Liquidity and Capital Resources**

Consistent with our history, our current and long-term liquidity could be impacted by a number of challenges, including, but not limited to: (i) potential future reductions in our revenues resulting from governmental and public policy changes, including regulatory actions affecting inter-carrier compensation and changes in revenue from Universal Service Funds; (ii) servicing our debt and funding principal payments; (iii) the funding of other obligations, including our pension plans and lease commitments; (iv) competitive pressures in the markets we serve; (v) the capital intensive nature of our industry; (vi) our ability to respond to and fund the rapid technological changes inherent to our industry, including new products; and (vii) our ability to obtain adequate financing to support our business and pursue growth opportunities.

We are responding to these challenges by (i) driving top line growth in broadband service revenues with a focus on business and wholesale customers; (ii) managing our cost structure to deliver consistent Adjusted EBITDA and Adjusted Free Cash flow performance; and (iii) holding capital spending to approximately \$35 million annually.

As of December 31, 2016, total long-term obligations outstanding, including current portion, were \$184.1 million, consisting of \$86.8 million in term loans under our 2015 Senior Credit Facilities, \$94.0 million of convertible notes, and \$3.3 million in capital lease and other obligations. As of December 31, 2016, we had \$21.2 million in cash and access to the full amount of the \$10.0 million revolving credit facility under our 2015 Senior Credit Facilities.

As described in more detail below, we announced on March 13, 2017 our refinancing transaction, which will result in the extension of scheduled principal payments on our credit agreements from 2018 out through 2023, and the forthcoming tender offer on our 6.25% Notes.

We believe that we will have sufficient cash on hand, cash provided by operations and available borrowing capacity under our revolving credit facility to service our debt, and fund our operations, capital expenditures and other obligations over the next twelve months. However, our ability to make such an assessment is dependent upon our future financial performance, which is subject to future economic conditions and to financial, business, regulatory, competitive entry and many other factors, many of which are beyond our control and could impact us during the time period of this assessment.

### ***2015 Senior Credit Facilities***

As described below, proceeds from our 2017 Senior Credit Facility will be used, in part, to repay in full our 2015 Senior Credit Facilities. The following description of the 2015 Senior Credit Facilities is as of December 31, 2016.

On September 14, 2015, we entered into the \$100.0 million Senior Credit Facilities which consists of a \$65.0 million first lien term loan, a \$25.0 million second lien term loan, both of which were drawn at December 31, 2016, and a \$10.0 million revolving credit facility which was undrawn at December 31, 2016. At December 31, 2016, we had full access to the \$10.0 million under the revolving credit facility.

Unless extended as described below, quarterly principal payments on the term loan component of the first lien term loan were \$250 thousand in the fourth quarter of 2015, \$750 thousand in each quarter of 2016, and \$1.0 million in each quarter of 2017. The remaining principal balance, including any amounts outstanding under the revolving credit facility, is due in its entirety on January 2, 2018. Unless extended as described below, the second lien term loan is due in its entirety on March 3, 2018, and may be prepaid in whole or in part at the Company's option prior to maturity.

The First Lien Facility may be extended to June 30, 2020 and the Second Lien Facility may be extended to September 30, 2020 if the Company (i) has refinanced or repurchased its 6.25% Notes such that no

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more than \$30.0 million of principal amount is outstanding (with cash available for their repayment at maturity) and any replacement notes have a maturity date not earlier than December 31, 2020, (ii) has achieved certain liquidity requirements, and (iii) is otherwise compliant with the terms of the 2015 Senior Credit Facilities. In the event the 2015 Senior Credit Facilities are extended, principal payments on the term loan component of the First Lien Facility subsequent to 2017 would be \$1.25 million in each quarter of 2018 and \$1.5 million in each quarter of 2019 and the first quarter of 2020. The remaining principal balance, including any amounts outstanding under the revolving credit facility, would be due in its entirety on June 30, 2020. The Second Lien Facility has similar extension conditions and would be due in its entirety on September 30, 2020. Subject to a declining prepayment fee, it may be prepaid in whole or in part at the Company's option prior to maturity.

The 2015 Senior Credit Facilities provide for events of default, including non-payment defaults on other debt, misrepresentation, breach of covenants, representations and warranties, change of control, and insolvency and bankruptcy.

Certain terms, including the maintenance of certain financial ratios, of our 2015 Senior Credit Facilities as defined in the 2015 Senior Credit Agreements are summarized below. Consolidated EBITDA as defined in the 2015 Senior Credit Agreements and summarized below is not a GAAP measure and is not consistent with Adjusted EBITDA presented elsewhere in Management's Discussion and Analysis of Financial Condition and Results of Operations.

	<b>First Lien Term Loan</b>	<b>Second Lien Term Loan</b>
Interest rate:		
Margin over LIBOR	4.50%	8.50%
LIBOR floor	1.00%	1.00%
Net Total Leverage to Consolidated EBITDA Ratio Limit:		
September 14, 2015 through December 31, 2016	3.750	4.310
January 1, 2017 through December 31, 2017	3.250	3.740
January 1, 2018 and thereafter	3.000	3.450
Senior Leverage to Consolidated EBITDA Ratio Limit:		
September 14, 2015 through December 31, 2016	2.500	2.875
January 1, 2017 through December 31, 2018	2.250	2.588
January 1, 2019 and thereafter	2.000	2.300
Consolidated EBITDA to Debt Service Coverage Ratio Minimum:		
September 14, 2015 and thereafter	2.000	1.700

*Net Total Leverage Ratio:* The ratio of our (a) adjusted total debt to (b) Consolidated EBITDA (as defined more specifically below). Payment of cash dividends on and repurchase of the Company's common stock is not permitted until such time that the Company's Net Total Leverage Ratio is not more than 2.75 to 1.00.

*Senior Leverage Ratio:* The ratio of our (a) senior indebtedness to (b) Consolidated EBITDA for the consecutive four fiscal quarters ending as of the calculation date.

*Debt Service Coverage Ratio:* The ratio of Consolidated EBITDA for the consecutive four fiscal quarters ending as of the calculation date to (b) the sum of (i) cash annualized consolidated interest expense and (ii) scheduled principal payments on debt for the four fiscal quarters immediately following the calculation date.

*Consolidated EBITDA*, as defined in the 2015 Senior Credit Facilities, means consolidated net income, plus the sum of:

cash and non-cash interest expense;

depreciation and amortization expense;

income taxes;

other non-cash charges and expense, including equity-based compensation expense;

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the write down or write off on any assets, other than accounts receivable;

subject to limitation, fees and out-of-pocket transaction costs incurred in connection with the 2015 refinancing transactions;

certain costs associated with the sale of the Company's wireless operations and subsequent wind-down.

extraordinary, non-recurring or unusual losses;

one-time costs associated with permitted acquisitions; and

transaction costs and similar amounts required to be expensed under Accounting Standards Codification 805.

minus (to the extent included in determining consolidated net income) the sum of:

Extraordinary, non-recurring or unusual gains on permitted sales or dispositions of assets and casualty events;

Cash and non-cash interest income;

Other extraordinary items or nonrecurring items;

The write up of any asset; and

the Company's share of earnings in its joint venture with Quintillion if such earnings exceed \$0.5 million and at least 50% of the Company's share in such earnings have not been received in cash by the Company.

The revolving credit facility component of the First Lien Facility bears interest at 4.5% with a LIBOR minimum of 1.0% and a commitment fee of 0.25% on the average daily unused portion. Any amounts outstanding under the revolving credit agreement are due on January 2, 2018.

The weighted interest rate on the 2015 Senior Credit Facilities was 6.59% at December 31, 2016.

As disclosed below, we were in compliance with all financial covenant ratios as of December 31, 2016.

<i>Net Total Leverage to Consolidated EBITDA Ratio:</i>	
First Lien Term Loan	2.82
Second Lien Term Loan	2.82
<i>Senior Leverage to Consolidated EBITDA Ratio:</i>	
First Lien Term Loan	1.55
Second Lien Term Loan	1.55
<i>Consolidated EBITDA to Debt Service Coverage Ratio:</i>	
First Lien Term Loan	3.55
Second Lien Term Loan	3.55

As required under the terms of the First Lien Facility of the 2015 Senior Credit Facilities and as a component of its cash flow hedging strategy, the Company entered into a pay-fixed, receive-floating interest rate swap in the notional amount of \$44.8 million in the fourth quarter of 2015. The interest rate on the swap is 5.833% inclusive of a 4.5% LIBOR spread. The swap began on November 27, 2015 and is expected to continue through December 31, 2017.

### ***Other Debt Instruments***

The balance of our 6.25% Notes due in 2018 was \$94.0 million as of December 31, 2016.

Pursuant to the 2017 Senior Credit Facility, we intend to commence a tender offer for our outstanding 6.25% Convertible Notes due 2018. The offer will commence upon the filing of Schedule TO with the Securities and Exchange Commission.

### ***2017 Credit Facility***

On March 13, 2017, we entered into the 2017 Senior Credit Facility consisting of a Term A-1 Facility of \$120.0 million, a Term A-2 Facility of \$60.0 million and a Revolving Facility of \$15.0 million. Upon the satisfaction of certain conditions, on or before March 28, 2017, the Company will utilize proceeds from the 2017 Senior Credit Facility and cash on hand to repay in full its 2015 Senior Credit Facilities, including accrued interest and fees, of approximately \$87.8 million, fund the tender of its 6.25% Notes in the amount of \$94.0 million and fund fees and expenses associated with this transaction.

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The Term A-1 Facility and draws under the Revolving Facility bear interest at LIBOR plus 5.0% per annum, with a LIBOR minimum of 1.0%, or 4.0% per annum plus an Alternate Base Rate as defined in the Agreement. The Term A-2 Facility bears interest at LIBOR plus 7.0% per annum, with a LIBOR minimum of 1.0%, or 6.0% per annum plus an Alternate Base Rate as defined in the Agreement.

Principal payments on the Term A-1 Facility are \$1,500 thousand per quarter beginning in the fourth quarter of 2017 through the first quarter of 2020, \$2,250 thousand per quarter beginning in the second quarter of 2020 through the first quarter of 2021, and \$4,000 thousand per quarter beginning in the second quarter of 2021 through the fourth quarter of 2021. The remaining outstanding principal balance is due on March 13, 2022. Principal payments on the Term A-2 Facility are \$150 thousand per quarter beginning in the fourth quarter of 2017 through the first quarter of 2021 and \$600 thousand per quarter beginning in the second quarter of 2021 through the fourth quarter of 2022. The remaining outstanding principal balance is due on March 13, 2023.

Upon funding the obligations under the 2017 Senior Credit Facility will be secured by perfected first lien priority security interests in substantially all of the Company's and its direct and indirect subsidiary's tangible and intangible assets, subject to certain agreed exceptions.

The 2017 Senior Credit Facility contains customary representations, warranties and covenants, including covenants limiting the incurrence of debt, the payment of dividends and repurchase of the Company's common stock. Financial covenants include (i) a Maximum Net Total Leverage Ratio of 3.75 to 1.00 from the funding date of the Agreement through June 30, 2017, 3.50 to 1.00 through December 31, 2017, 3.25 to 1.00 through June 30, 2018, 3.00 to 1.00 through December 31, 2018, 2.75 to 1.00 through September 30, 2019 and 2.50 to 1.00 thereafter, and; (ii) a Minimum Fixed Charge Coverage Ratio of 1.05 to 1.00 from June 30, 2017 thereafter. The Agreement initially allows for the repurchase of up to \$10.0 million of the Company's common stock subject to certain conditions, with additional amounts allowed in the future subject to other conditions, including a Maximum Net Total Leverage Ratio of 2.50 to 1.00.

The 2017 Senior Credit Facility provides for events of default customary for credit facilities of this type, including non-payment defaults on other debt, misrepresentation, breach of covenants, representations and warranties, change of control, and insolvency and bankruptcy.

All terms are defined in the Agreement. See the Credit Agreement dated as of March 13, 2017, by and among Alaska Communications, as the borrower, the Company and certain of its direct and indirect subsidiaries, as guarantors, ING Capital LLC, as administrative agent, and the lenders party thereto filed as Exhibit 10.1 to the Current Report on Form 8-K filed on March 15, 2017.

***Contractual Obligations***

Our contractual obligations as of December 31, 2016, are presented in the following table. Generally, long-term liabilities are included in the table based on the year of required payment or an estimate of the year of payment. Such estimates of payment are based on a review of past trends for these items as well as a forecast of future activities. As described below, certain items were excluded from the following table where the year of payment is unknown and could not be reasonably estimated.

(in thousands)	<b>Total</b>	<b>2017</b>	<b>2018-2019</b>	<b>2020-2021</b>	<b>Thereafter</b>
Long-term debt	\$ 184,075	\$ 1,973	\$ 179,375	\$ 119	\$ 2,608

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Interest on long-term debt	17,430	12,070	2,934	526	1,900
Capital leases	3,325	323	275	119	2,608
Operating leases	50,504	7,634	12,581	8,830	21,459
Unconditional purchase obligations	50,988	6,429	7,989	6,497	30,073
Total contractual cash obligations	\$ 306,322	\$ 28,429	\$ 203,154	\$ 16,091	\$ 58,648

As described above, on March 13, 2017, we entered into the 2017 Senior Credit Facility. See Note 11 *Long-term Obligations* and Note 22 *Subsequent Events* in the Notes to Consolidated Financial



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Statements. Consummation of this agreement prior to issuance of the Company's financial statements demonstrated the Company's intent and ability to refinance a portion of its current obligations in accordance with Accounting Standards Codification 470 Debt. Current maturities under the Company's 2015 Senior Credit Facilities totaling \$4,000 at December 31, 2016 were effectively replaced by principal payments totaling \$1,650 under the 2017 Senior Credit Facility. Accordingly, current portion of long-term obligations in the amount of \$2,350 was reclassified to long-term obligations at December 31, 2016. The schedule of contractual obligations at December 31, 2016 above reflects this reclassification only, and does not reflect all changes in debt maturities resulting from this transaction.

Scheduled principal payments on long-term debt assuming payments under the 2017 Senior Credit Facility and repayment in full of the principal amounts due under the 2015 Senior Credit Facilities and tender of the 6.25% Notes in 2017 with proceeds from the 2017 Senior Credit Facility are as follows:

(in thousands)	<b>Total</b>	<b>2017</b>	<b>2018-2019</b>	<b>2020-2021</b>	<b>Thereafter</b>
<b>Long-term debt</b>	<b>\$ 183,325</b>	<b>\$ 1,973</b>	<b>\$ 13,475</b>	<b>\$ 25,169</b>	<b>\$ 142,708</b>

The total pension benefit liability associated with the Alaska Communications Retirement Plan recognized on the consolidated balance sheet as of December 31, 2016 and December 31, 2015 were \$4.4 million and \$4.9 million, respectively, and is included in Other long-term liabilities. Because this liability is impacted by, among other items, plan funding levels, changes in plan demographics and assumptions, and investment return on plans assets, it does not represent expected liquidity needs. Accordingly, we did not include this liability in the Contractual Obligations table. We made cash contributions of \$0.8 million in 2016 and \$0.8 million in 2015. This plan is not fully funded.

We also participate in the AEPF, a multi-employer defined benefit plan, to which we pay a contractual hourly amount based on employee classification or base compensation. We contributed \$7.5 million, \$8.0 million and \$8.6 million to this plan in 2016, 2015 and 2014, respectively. Minimum required future contributions to this plan are subject to the number of employees in each classification and/or base compensation of employees in future years and, therefore, are not included in the Contractual Obligations table. This plan is not fully funded.

As of December 31, 2016 and December 31, 2015, the Company had an accumulated asset retirement obligation of \$3.7 million and \$3.4 million. This liability was not included in the Contractual Obligations table due primarily to the uncertainty as to the timing of future payments.

As of December 31, 2016 and December 31, 2015, the Company had deferred tax liabilities totaling \$53.0 million and \$43.8 million, exclusive of deferred tax assets. The balance at December 31, 2016 is not included in the Contractual Obligations table because the Company believes this presentation would not be meaningful. Deferred income tax liabilities are calculated based on temporary differences between the tax basis of assets and liabilities and their book basis, which will result in taxable amounts in future years when the book basis is settled. The results of these calculations do not have a direct connection with the amount of cash taxes to be paid in any future periods. At December 31, 2016, the Company had Federal and state net operating loss carry forwards of \$67.5 million and \$46.0 million, respectively, with various expiration dates beginning in 2031 through 2036. At December 31, 2016, the Company had valuation allowances on certain state net operating loss carryforwards totaling \$0.1 million. With the exception of these state net operating loss carryforwards, the Company currently expects that all other net operating loss carry forwards will be utilized.

The Company has entered into capacity agreements which will require future payments upon completion of the North Slope fiber optic network. These payments have been excluded from the table due to the uncertainty of the amount and timing of future payments.

Funding obligations associated with our self-insurance programs have been excluded from the table due primarily to the uncertainty as to the timing of future payments.

***NON-GAAP FINANCIAL MEASURES***

The Company provides certain non-GAAP financial information, including Adjusted EBITDA, Adjusted Free Cash Flow and Net Debt. Adjusted EBITDA and Adjusted Free Cash Flow measure the Company's primary business activities without regard for the effects of special items and income tax structure.

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Adjusted EBITDA eliminates the effects of period to period changes in costs that are not directly attributable to the underlying performance of the Company's business operations and is used by Management and the Company's Board of Directors to evaluate current operating financial performance, analyze and evaluate strategic and operational decisions and better evaluate comparability between periods. Adjusted Free Cash Flow is a non-GAAP liquidity measure used by Management and the Board of Directors to assess the Company's ability to generate cash and plan for future operating and capital actions. Adjusted EBITDA and Adjusted Free Cash Flow are common measures utilized by our peers (other telecommunications companies) and we believe they provide useful information to investors and analysts about the Company's operating results, financial condition and cash flows. Net Debt provides Management and the Board of Directors with a measure of the Company's current leverage position.

Adjusted EBITDA is defined as net income (loss) before interest, loss on extinguishment of debt, depreciation and amortization, loss on impairment of goodwill, gain or loss on asset purchases or disposals including the sale of our wireless operations, earnings from equity method investments, income taxes, Wireless Sale transaction and wind-down related costs, stock-based compensation, pension adjustments, earthquake related expenses, gift of services, net loss attributable to noncontrolling interest and expenses under the Company's long term cash incentive plan ( LTIC ). LTIC expenses are considered part of an interim compensation structure, which ended in 2016, to mitigate the dilutive impact of additional share issuances for executive compensation. Distributions from AWN are included in Adjusted EBITDA.

Management considers Adjusted Free Cash Flow a non-GAAP liquidity measure and is defined as Adjusted EBITDA, less recurring operating cash requirements which include capital expenditures, net of cash received for a fiber build for a carrier customer, less cash interest paid, amortization of GCI/AWN capacity revenue, earthquake related expenses, and cash receipts and payments associated with the purchase of the North Slope fiber network and establishment of our joint venture with QHL. Amortization of deferred revenue associated with our interconnection agreement with AWN and GCI is excluded from Adjusted Free Cash Flow because no cash was received by the Company in connection with this agreement. Amortization of all other deferred revenue, including that associated with other IRU capacity arrangements, is included in Adjusted Free Cash Flow because cash was received by the Company, typically at contract inception, and is being amortized to revenue over the term of the relevant agreement. Amortization of deferred revenue included in our operating revenues for the years ended December 31, 2016, 2015 and 2014, were as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
GCI/AWN capacity revenue	\$ 2,082	\$ 2,169	\$ 3,151
Other deferred capacity revenue	1,354	842	644
<b>Total deferred capacity revenue</b>	<b>3,436</b>	<b>3,011</b>	<b>3,795</b>
Other deferred revenue	3,574	2,816	2,736
<b>Total</b>	<b>\$ 7,010</b>	<b>\$ 5,827</b>	<b>\$ 6,531</b>

The Company does not provide reconciliations of guidance for Adjusted EBITDA to Net Income, and Adjusted Free Cash Flow to Net Cash Provided by Operating Activities, in reliance on the unreasonable efforts exception provided under Item 10(e)(1)(i)(B) of Regulation S-K. The Company does not forecast certain items required to develop the comparable GAAP financial measures. These items are realized and unrealized gains and losses on effective and ineffective hedges, charges and benefits for uncollectible accounts, certain other non-cash expenses, unusual items typically excluded from Adjusted EBITDA and Adjusted Free Cash Flow, and changes in operating assets and

liabilities (generally the most significant of these items, representing cash outflows of \$6.1 million and \$3.9 million in the years ended December 31, 2016 and 2015, respectively and a cash inflow of \$8.4 million in the year ended December 31, 2014).

Adjusted EBITDA and Adjusted Free Cash Flow are not GAAP measures and should not be considered a substitute for Net Income, Net Cash Provided by Operating Activities, or Net Cash Provided or Used. Adjusted EBITDA as computed below is not consistent with the definition of Consolidated EBITDA referenced in our 2015 Senior Credit Agreements and 2017 Senior Credit Facility, and other companies may not calculate Non-GAAP measures in the same manner we do.

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The following tables provide the computation of Adjusted EBITDA and reconciliation to Net Income (Loss), and the computation of Adjusted Free Cash Flow and reconciliation to Net Cash Provided by Operating Activities for the years ended December 31, 2016, 2015 and 2014:

**Adjusted EBITDA**

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income (loss)	\$ 2,253	\$ 12,885	\$ (2,780)
Add (subtract):			
Interest expense	15,447	19,841	34,410
Loss on extinguishment of debt	336	4,878	
Interest income	(26)	(58)	(83)
Depreciation and amortization	34,690	33,867	32,583
Loss on impairment of goodwill			5,986
Loss (gain) on disposal of assets, net	321	(46,252)	126
Earnings from equity method investments		(3,056)	(35,960)
AWN distributions received/receivable, net		765	50,000
Income tax expense (benefit)	1,499	10,200	(1,787)
Stock-based compensation	2,830	2,008	2,511
Long-term cash incentives	764	1,781	2,042
Pension adjustment		134	
Gift of services		(388)	
Earthquake related expenses			1,228
Net loss attributable to noncontrolling interest	133	69	
Wireless sale transaction-related and wind down costs		13,272	4,297
Adjusted EBITDA	\$ 58,247	\$ 49,946	\$ 92,573

**Table of Contents****Reconciliation of Net Cash Provided by Operating Activities to Adjusted****Free Cash Flow and Computation of Adjusted Free Cash Flow**

	2016	2015	2014
Net cash provided by operating activities	\$ 37,253	\$ 12,581	\$ 51,169
Adjustments to reconcile net cash provided by operating activities to adjusted free cash flow:			
Capital expenditures excluding acquisition price of North Slope fiber network	(30,920)	(39,914)	(46,423)
Milestone billings for fiber build project for a carrier customer		7,000	5,960
Purchase of North Slope fiber network:			
Acquisition price		(11,000)	
(Paid) less: 50% due in 2016	(5,500)	5,500	
Proceeds on sale of fiber to joint venture partner	2,650	2,650	
Other cash proceeds		400	
Amortization of deferred capacity revenue	3,436	3,011	3,795
Amortization of GCI/AWN capacity revenue	(2,082)	(2,169)	(3,151)
Amortization of debt issuance costs and debt discount	(4,046)	(4,114)	(5,104)
Interest expense	15,447	19,841	34,410
Interest paid	(12,608)	(16,101)	(31,562)
Interest income	(26)	(58)	(83)
Unrealized gain on ineffective hedge		737	273
Amortization of ineffective hedge		(1,970)	(1,613)
Income tax expense (benefit)	1,499	10,200	(1,787)
Income taxes payable	514	351	
Deferred income tax (expense) benefit	(1,855)	(4,883)	2,047
Charge for uncollectible accounts	(378)	(1,258)	(3,329)
Cash distribution from equity method investments		(3,056)	(35,960)
Long-term cash incentives	764	1,781	2,042
Pension adjustment		134	
Gift of services		(388)	
Net loss attributable to noncontrolling interest	133	69	
Wireless sale transaction-related and wind down costs		13,272	4,297
AWN distributions received/receivable, net		765	50,000
Other non-cash expense, net	(621)	(934)	(431)
Changes in operating assets and liabilities	6,127	3,865	(8,381)
Adjusted free cash flow	\$ 9,787	\$ (3,688)	\$ 16,169
Adjusted EBITDA	\$ 58,247	\$ 49,946	\$ 92,573
Less:			
Capital expenditures excluding acquisition price of North Slope fiber network	(30,920)	(39,914)	(46,423)
Milestone billings for fiber build project for a carrier customer		7,000	5,960

Net capital expenditures	(30,920)	(32,914)	(40,463)
Purchase of North Slope fiber network			
Acquisition price		(11,000)	
(Paid) less: 50% due in 2016	(5,500)	5,500	
Proceeds on sale of fiber to joint venture partner	2,650	2,650	
Less: other cash proceeds		400	
Net North Slope purchase	(2,850)	(2,450)	
Amortization of GCI/AWN capacity revenue	(2,082)	(2,169)	(3,151)
Earthquake related expense			(1,228)
Interest paid	(12,608)	(16,101)	(31,562)
Adjusted free cash flow	\$ 9,787	\$ (3,688)	\$ 16,169

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### **OUTLOOK**

#### **Operating Results, Liquidity and Capital Resources**

We expect to see continued strength in business and wholesale revenues, led by broadband revenue and managed IT services. These revenue increases are driven by continued demand for broadband as businesses migrate their IT infrastructure to the cloud, expansion into managed IT services and continued gain in market share. We expect margins will strengthen through the course of the year. Strategically, we continue to evaluate opportunities to advance our position as the premier cloud enabler for businesses.

We expect variable growth in equipment sales, as this revenue stream is impacted by non-recurring transactions. We expect access revenues to continue to decline as voice traffic experiences decline with long distance carriers. As the only price cap carrier in Alaska, we will receive approximately \$19.7 million annually in high cost support for the next nine years under the CAF II order issued in the fourth quarter of 2016. This is the same amount we received under the CAF I high cost frozen support.

We currently anticipate total revenue of \$229 million to \$235 million and Adjusted EBITDA of \$59 million to \$61 million in 2017, subject to achieving our targeted revenue growth. Capital expenditures in 2017 are currently targeted to be \$35 million to \$38 million. As discussed above, the Company does not provide a reconciliation of guidance for Adjusted EBITDA to Net Income.

As described above, we announced on March 13, 2017 our refinancing transaction, which will extend scheduled principal payments on our credit agreements from 2018 out through 2023, and the forthcoming tender offer on our 6.25% Notes. On March 13, 2017, we also announced that our Board of Directors authorized a stock repurchase program for the Company to repurchase up to \$10.0 million of its Common Stock through December 2019, which is effective beginning no earlier than in the second quarter of 2017.

### **ADDITIONAL INFORMATION**

#### **Off-Balance Sheet Arrangements**

We have no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity or market or credit risk support and we do not engage in leasing, hedging, research and development services or other relationships that expose us to any material liabilities that are not reflected on our balance sheet or included in Contractual Obligations above.

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

The preparation of our consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires us 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.

We have identified certain policies and estimates as critical to our business operations and the understanding of our past or present results of operations. We consider these policies and estimates critical because they had a material impact, or they have the potential to have a material impact, on our financial statements and they require significant judgments, assumptions or estimates.



## **Revenue Recognition Policies**

Substantially all recurring non-usage sensitive 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. Revenue is recognized on the sale of equipment upon acceptance by the customer. Certain of our bundled products and services 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 selling price. Monthly service revenue from the majority of our customer base is recognized as services are rendered.

## **Income Taxes**

We use the asset-liability method of accounting for income taxes and account for income tax uncertainties using the more-likely-than-not threshold. Under the asset-liability method, deferred taxes reflect the

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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 management determines it is more-likely-than-not that the value of our deferred tax assets will not be fully realized.

**Recently Issued Accounting Pronouncements*****Accounting Pronouncements Adopted***

In the first quarter of 2016, the Company adopted Accountings Standards Update ( ASU ) No. 2015-05, *Intangibles Goodwill and Other Internal-Use Software (Subtopic 350-40), Customer s Accounting for Fees Paid in a Cloud Computing Arrangement* ( ASU 2015-05 ). The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. As provided by ASU 2015-05, the Company adopted the update prospectively to all arrangements entered into or materially modified beginning in 2016. Adoption of ASU 2015-05 did not have a material effect on the Company s consolidated financial statements and related disclosures in the fiscal year ended December 31, 2016.

***Accounting Pronouncements Issued Not Yet Adopted***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ( ASU 2014-09 ). The amendments in ASU 2014-09 require that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB deferred the effective date of ASU 2014-09 from annual periods beginning after December 15, 2016 to annual periods beginning after December 15, 2017. In April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing* ( ASU 2016-10 ). This update provides further guidance on two aspects of Topic 606: (i) identifying performance obligations; and (ii) implementation of licensing guidance. In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606), Narrow-Scope Improvements and Practical Expedients* ( ASU 2016-12 ). This update (i) clarifies the objective of the collectability criterion; (ii) permits an entity to exclude amounts collected from customers for all sales and other similar taxes from the transaction price; (iii) specifies that the measurement date for noncash consideration is contract inception; (iv) provides a practical expedient for addressing contract modifications; (v) clarifies the definition of a completed contract for transition purposes; and (vi) clarifies certain retrospective adoption guidance. In December 2016, the FASB issued ASU No. 2016-20, *Revenue from Contracts with Customers (Topic 606), Technical Corrections and Improvements* ( ASU 2016-20 ). This update clarifies or corrects the applications of certain aspects of Topic 606 including: (i) impairment testing of contract costs; (ii) disclosure of remaining performance obligations; and (iii) disclosure of revenue recognized from performance obligations satisfied in previous periods. ASU 2016-10, ASU 2016-12 and ASU 2016-20 do not change the core principles of the guidance in Topic 606. The Company s assessment of ASU 2014-09 and subsequent updates is ongoing and is currently expected to be completed during the second or third quarter of 2017. This assessment includes determining the effect of the new standard on the Company s financial statements, accounting systems, business processes, and internal controls. The Company has not yet finalized its assessment of the impact of the new standard on its recognition of revenue. It is currently expected that adoption of the new standard will result in the deferral of certain contract costs, including certain sales commissions, which are currently expensed as incurred. Such deferred costs will be amortized over the period that the associated revenue is recognized. Implementation of required changes to the Company s accounting systems, business processes and internal

controls will commence upon completion of the assessment. The Company will adopt ASU 2014-09 effective January 1, 2018 and has not yet selected an adoption method.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ( ASU 2016-02 ). The primary change in GAAP addressed by ASU 2016-02 is the requirement for a lessee to recognize on the balance sheet a liability to make lease payments ( lease liability ) and a right-of-use asset representing its

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right to use the underlying asset for the lease term. For finance leases, a lessee is required to (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments; (ii) recognize interest on the lease liability separately from amortization of the right-of-use asset; and (iii) classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, a lessee is required to (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments; (ii) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and (iii) classify all cash payments within operating activities in the statement of cash flows. For leases with a term of twelve months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. ASU 2016-02 also requires qualitative and quantitative disclosures to enable users of the financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). The amendments in ASU 2016-09 simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Provisions include (i) all excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit in the income statement; (ii) the tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur; (iii) an entity should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period; (iv) excess tax benefits should be classified as an operating activity; (v) an entity may make an accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur; (vi) the threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates; and (vii) cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods within those years. Adoption will be applied prospectively, retrospectively or using a modified retrospective method as required by the specific provisions. The Company currently intends to adopt the provisions of ASU 2016-09 in 2017 and does not currently expect that adoption will have a material effect on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments* (ASU 2016-15). The amendments in this update address eight specific cash flow classification issues for which current GAAP either is unclear or does not include specific guidance, and for which there exists diversity in practice: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted, including adoption in an interim period. Adoption is to be applied using a retrospective transition method to each period presented. The Company is evaluating the effect that ASU 2016-15 will have on its

consolidated financial statements and related disclosures, and does not currently expect the effect to be material.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230), Restricted*

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*Cash* ( ASU 2016-18 ). The amendments in this update require that the statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts described as restricted cash or restricted cash equivalents. Amounts described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the statement of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. Early adoption is permitted, including adoption in an interim period, and should be applied on a retrospective basis. The Company is evaluating the effect that ASU 2016-18 will have on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805), Clarifying the Definition of a Business* ( ASU 2017-01 ). The amendments in this update provide guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 provides that, when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar assets, the asset or group is not a business. If the above criteria are not met, ASU 2017-01 requires that to be considered a business, the asset or asset group must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. The requirement to evaluate whether a market participant could replace missing elements is eliminated. The amendments provide a framework to assist entities in evaluating whether both an input and a substantive process are present. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. Adoption is to be applied prospectively. Early adoption is permitted under certain circumstances. The effect of ASU 2017-01 on the Company's financial statements and related disclosures is dependent on its future business and asset acquisitions and dispositions.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Our primary exposure to market risk is associated with changes in interest rates. The interest rates and cash interest payments were substantially fixed on approximately \$137.8 million, or 76%, of our total borrowings of \$181.1 million, as of December 31, 2016. Our 6.25% Notes have a fixed coupon rate. The \$65.0 million First Lien Term Loan of our 2015 Senior Credit Facilities bears interest of LIBOR plus 4.5% with a LIBOR floor of 1.0% and the \$25.0 million Second Lien Term Loan bears interest of LIBOR plus 8.5% with a LIBOR floor of 1.0% as of December 31, 2016.

We manage a portion of our exposure to fluctuations in LIBOR and the resulting impact on interest expense and cash interest payments on our 2015 Senior Credit Facilities through the utilization of a pay-fixed, receive-floating interest rate swap designated as a cash flow hedge. As of December 31, 2016, interest expense on \$42.8 million, or 50%, of the amount outstanding under the 2015 Senior Senior Credit Facilities was hedged. A hypothetical 100 basis point increase in LIBOR over the floor of 1.0% during 2016 would result in an approximately \$0.4 million increase in interest expense and cash interest payments associated with the unhedged portion of the 2015 Senior Credit Facilities.

Subsequent to consummation of the refinancing transaction described above, including completion of the tender offer for our 6.25% Notes, the proportion of our cash interest payments that will be substantially fixed will differ from that described above. Under the terms of the 2017 Senior Credit Facility, we are required to hedge a portion of the variable rate interest payments under the agreement.

## **Liquidity Risk**

Our debt, specifically its term and maturity, could have a material adverse effect on our available liquidity. See the matters described in Item 1A, Risk Factors Risks Relating to Our Debt.



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**Item 8. Financial Statements and Supplementary Data**

Consolidated financial statements of Alaska Communications Systems Group, Inc. and Subsidiaries, and the financial statements of AWN (as required under Regulation S-X, Rule 3-09) are submitted as a separate section of this Form 10-K. See Index to Consolidated Financial Statements, which appears on page F-1 hereof. Financial statements of AWN as required under Regulation S-X, Rule 3-09 are provided as of December 31, 2014 and 2013, for the year ended December 31, 2014 and for the period from July 23, 2013 through December 31, 2013. The Company sold its equity interest in AWN effective February 2, 2015. Financial statements of AWN as of February 2, 2015 and for the period from January 1, 2015 through February 2, 2015 have not been provided because the results of AWN were not material to the Company's consolidated financial results in 2015. Also, financial statements of AWN as of February 2, 2015, for the period January 1, 2015 through February 2, 2015 and for the full year 2015 are not available.

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

None.

**Item 9A. Controls and Procedures**

**a. Evaluation of Disclosure Controls and Procedures.**

As of the end of the period covered by this Annual Report on Form 10-K, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and our Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934.

Based on the evaluation, our Chief Executive Officer and our Principal Financial Officer believe that, as of the end of the period covered by this Annual Report on Form 10-K, our disclosure controls and procedures were effective at ensuring that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

**b. 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 Rules 13a-15(f) and 15d-15(f). Internal control over financial reporting refers to a process designed by, or under the supervision of, our Chief Executive Officer and Principal Financial Officer and effected by our board of directors, management and other personnel, 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 and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;



provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our 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.

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Under the supervision and with the participation of our management, including our Chief Executive Officer and our Principal Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria in the Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO 2013 Framework ).

Based on our evaluation using the Internal Control Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

Our independent registered public accounting firm has issued an attestation report on the Company's internal control over financial reporting, which is included in Item 8, Financial Statements and Supplementary Data of the Annual Report on Form 10-K.

### **c. Changes in Internal Control over Financial Reporting.**

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Principal Financial Officer, we have evaluated any changes in our internal controls during the fourth quarter of 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Other than disclosed below, there were no material changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **d. Remediation of Material Weaknesses**

As disclosed under Item 9A. Controls and Procedures in our Annual Report on Form 10-K for the year ended December 31, 2015, management identified material weaknesses in internal control over financial reporting relating to (i) the effective design, operation and documentation of controls over the accounting for income taxes and (ii) the design and documentation of management review controls and other controls over the accounting and presentation of complex, non-routine transactions, including controls addressing the completeness and accuracy of key assumptions and other data used in the analysis of such transactions. A material weakness, as defined in Rule 12b-2 under the Exchange Act, is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. Based on the material weaknesses identified above, management concluded that our internal control over financial reporting was not effective as of December 31, 2015.

With the oversight of senior management and our audit committee, the accounting and finance team developed a plan to remediate the underlying causes of the material weaknesses. This plan included (i) a complete review of all controls involving significant judgment to ensure they provide the appropriate level of precision to facilitate effective management review; (ii) providing additional training to control and process owners addressing the design of effective controls and the importance of thoroughly documenting the performance of each control; (iii) the realignment of the control structure of our income tax function, including having the underlying work performed by management and the more complex review processes performed by third party consultants; and (iv) the engagement of a third-party firm to perform an independent assessment of the overall structure and environment of our internal control over financial reporting.

In the second quarter of 2016, we completed the review of all controls involving significant judgment, provided additional training to control and process owners and realigned the control structure of the income tax function. In the third quarter of 2016, the third-party assessment of the overall structure and environment of our internal control over financial reporting was completed and the results were presented to management and our audit committee. Recommendations for improving the documentation of controls and a risk assessment associated with financial reporting were provided by the third-party firm. Management, with the oversight of the audit committee, engaged a third-party firm to centralize and provide internal control over financial reporting services and assist with implementation of the

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recommendations referenced above. Implementation of the recommendations was completed during the third quarter of 2016. In the fourth quarter of 2016, the design, documentation and implementation of controls over the accounting for income taxes and the design and implementation of management review controls and other controls over the accounting and presentation of complex, non-routine transactions were completed. The controls were reviewed, assessed and, where available, tested by management with the assistance of the third-party firm. Based on these procedures, management has concluded that, as of December 31, 2016, the material weaknesses have been remediated.

**Item 9B. Other Information**

Not applicable.

**PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item is incorporated into this Form 10-K by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders.

**Item 11. Executive Compensation**

Information on compensation of our directors and executive officers is incorporated into this Form 10-K by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders.

**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 into this Form 10-K by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders.

**Securities Authorized for Issuance under Equity Compensation Plans**

As of December 31, 2016, the number of securities remaining available for future issuance under equity compensation plans includes 1,682,922 shares under the Alaska Communications Systems Group, Inc. 2011 Incentive Award Plan and 645,200 shares under the Alaska Communications Systems Group, Inc. 2012 Employee Stock Purchase Plan.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights <sup>(1)</sup>	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity Compensation Plans	(a)	(b)	(c)
Approved by security holders:			

Restricted stock	3,125,610	\$	2,328,122
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(1) Outstanding rights consist of stock units without any exercise price.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information with respect to such contractual relationships is incorporated into this Form 10-K by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders.

**Item 14. Principal Accounting Fees and Services**

Information on our audit committee's pre-approval policy for audit services and information on our principal accounting fees and services is incorporated into this Form 10-K by reference to our Proxy Statement for our 2017 Annual Meeting of Stockholders.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

(a) The following documents are filed as a part of this report:

- (1) Financial Statements: Our consolidated financial statements are submitted as a separate section of this Form 10-K. See Index to Consolidated Financial Statements which appears on page F-1.
- (2) Financial Statement Schedules: Financial statement schedules are omitted because they are not applicable, not required, or because the required information is included in the consolidated financial statements or notes thereto.
- (3) The financial statements of AWN are filed as part of this report and are listed in the Index to Consolidated Financial Statements.
- (4) Exhibits: The exhibits to this report are listed below. Other than exhibits that are filed herewith, all exhibits listed below are exhibits of the Registrant and are incorporated herein by reference as exhibits thereto.

**Exhibit**

No.	Exhibit	Where Located
2.1**	Stock Purchase Agreement, dated April 1, 2008, by and among the Registrant, Crest Communications Corporations, and the selling stockholders specified therein.	Exhibit 2.1 to Form 8-K (filed April 7, 2008)
2.2	Asset Purchase and Contribution Agreement, dated as of June 4, 2012, among Alaska Communications Systems Group, Inc., General Communication, Inc., ACS Wireless, Inc., GCI Wireless Holdings, LLC and The Alaska Wireless Network, LLC, with Form of First Amended and Restated Operating Agreement of The Alaska Wireless Network, LLC among The Alaska Wireless Network, LLC, GCI Wireless Holdings, LLC, ACS Wireless, Inc., Alaska Communications Systems Group, Inc. and General Communication, Inc. attached thereto as Exhibit A (portions of this Exhibit have been omitted pursuant to a request for confidential treatment under Rule 24b-2 under the Securities Exchange Act of 1934).	Exhibit 2.1 to Form 8-K (filed August 6, 2012)
2.3	Amendment, dated as October 1, 2012, to Asset Purchase and Contribution Agreement, dated as of June 4, 2012, among Alaska Communications Systems Group, Inc., General Communication, Inc., ACS Wireless, Inc., GCI Wireless Holdings, LLC and The Alaska Wireless Network, LLC.	Exhibit 2.1 to Form 8-K (filed October 2, 2012)

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3.1	Amended and Restated Certificate of Incorporation of the Registrant.	Exhibit 3.1 to Form S-1/A File No. 333-888753 (filed November 17,1999)
3.2	Amended and Restated By-Laws of the Registrant.	Exhibit 3.1 to Form 8-K (filed January 7, 2016)
4.1	Specimen of Common Stock Certificate.	Exhibit 4.1 to Form S-1/A File No. 333-888753 (filed November 17, 1999)

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4.2	Indenture, dated as of May 10, 2011, by and among the Company, the Guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as trustee, with respect to 6.25% Convertible Notes due 2018.	Exhibit 4.1 to Form 8-K (filed May 11, 2011)
10.1*	Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan.	Exhibit 10.8 to Form S-1/A File No. 333-888753 (filed November 17, 1999)
10.2*	Form of Restricted Stock Agreement between the Registrant and certain participants in the Registrant's 1999 Stock Incentive Plan.	Exhibit 10.1 to Form 10-Q (filed August 3, 2007)
10.3*	Form of Performance Share Unit Agreement.	Exhibit 99.1 to Form 8-K/A (filed June 12, 2008)
10.4*	Amendment to Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan.	Exhibit 10.5 to Form 10-K (filed March 9, 2010)
10.5*	Alaska Communications Systems Group, Inc. 1999 Non-Employee Director Compensation Plan.	Exhibit 10.9 to Form S-1/A File No. 333-888753 (filed November 17, 1999)
10.6*	Amendment to Alaska Communications Systems Group, Inc. 1999 Non-Employee Director Compensation Plan.	Exhibit 10.7 to Form 10-K (filed March 9, 2010)
10.7*	Alaska Communications Systems Group, Inc. 1999 Employee Stock Purchase Plan.	Exhibit 10.10 to Form S-1/A File No. 333-888753 (filed November 17, 1999)
10.8*	Alaska Communications Systems Group, Inc. 2012 Employee Stock Purchase Plan.	Appendix A to Schedule 14A (filed April 25, 2012)
10.9*	Amendment to Alaska Communications Systems Group, Inc. 1999 Employee Stock Purchase Plan.	Exhibit 10.9 to Form 10-K (filed March 9, 2010)
10.10	Amendment ratified on October 4, 2012, to Collective Bargaining Agreement, effective February 28, 2010, between Alaska Communications Systems Holdings, Inc. and the International Brotherhood of Electrical Workers, Local Union No. 1547.	Exhibit 10.1 to Form 8-K (filed October 10, 2012)
10.11	Collective Bargaining Agreement, effective February 28, 2010, between Alaska Communications Systems Holdings, Inc. and the International Brotherhood of Electrical Workers, Local Union No. 1547.	Exhibit 10.2 to Form 8-K (filed October 10, 2012)
10.12		



	Confirmations of Convertible Bond Hedges by and between Alaska Communications Systems Group, Inc. and certain affiliates of the Initial Purchasers.	Exhibit 10.2 to Form 8-K (filed April 14, 2008)
10.13	Confirmations of Warrant Transactions by and between Alaska Communications Systems Group, Inc. and certain affiliates of the Initial Purchasers.	Exhibit 10.3 to Form 8-K (filed April 14, 2008)

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10.14	Credit Agreement, dated as of October 21, 2010, by and among Alaska Communications Systems Holdings, Inc., as Borrower, Alaska Communications Systems Group, Inc, as Parent, several banks and other financial institutions or entities, as lenders named therein, and JPMorgan Chase Bank, N.A., as Administrative Agent.	Exhibit 10.1 to Form 8-K (filed October 26, 2010)
10.15	First Amendment to Credit Agreement, dated as of November 1, 2012, by and among Alaska Communications Systems Holdings, Inc., as Borrower, Alaska Communications Systems Group, Inc., as Parent, the lenders, and JPMorgan Chase Bank, N.A. as Administrative Agent.	Exhibit 10.4 to Form 10-Q (filed November 5, 2012)
10.16	Purchase Agreement, dated May 4, 2011, by and among the Company, the Guarantors named therein and J.P. Morgan Securities LLC, as representative of the several initial purchasers name therein.	Exhibit 10.1 to Form 8-K (filed May 11, 2011)
10.17*	Alaska Communications Systems Group, Inc. 2011 Incentive Award Plan Restricted Stock Unit Agreement.	Exhibit 10.1 to Form 8-K (filed July 8, 2011)
10.18*	Alaska Communications Systems Group, Inc. 2011 Incentive Award Plan Performance Stock Unit Agreement.	Exhibit 10.2 to Form 8-K (filed July 8, 2011)
10.19*	Alaska Communications Systems Group, Inc. Post-Employment Stock Incentive Award Vesting Policy.	Exhibit 10.3 to Form 8-K (filed July 8, 2011)
10.20*	Employment Arrangement between the Company and Leonard Steinberg.	Exhibit 10.1 to Form 8-K (filed January 26, 2012)
10.21*	Employment Agreement between the Company and Michael Todd.	Exhibit 10.37 to Form 10-K/A (filed September 14, 2012)
10.22*	2012 and 2013 Compensation Letter From Alaska Communications Systems Group, Inc. to Leonard Steinberg dated February 12, 2013.	Exhibit 10.31 to Form 10-K (filed March 1, 2013)
10.23*	2012 and 2013 Compensation Letter From Alaska Communications Systems Group, Inc. to Michael Todd dated February 12, 2013.	Exhibit 10.32 to Form 10-K (filed March 1, 2013)
10.24*	The Alaska Communications Systems Group, Inc. Amended and Restated 2011 Incentive Award Plan.	Exhibit 99.1 to Form S-8 File No. 333-199923 (Filed Nov 6, 2014)
10.25	The Second Amendment Agreement, dated December 23, 2014, to Credit Agreement, dated as of October 21, 2010 (as amended by the First Amendment Agreement to Credit Agreement, dated as of November 1, 2012) dated February 6, 2015.	Exhibit 10.2 to Form 8-K (filed March 5, 2015)

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10.26	Purchase and Sale Agreement, dated December 4, 2014, by and between ACS, GCI, ACS Wireless, GCI Wireless, and AWN.	Exhibit 10.1 to Form 8-K (filed March 5, 2015)
10.27*	Employment Agreement between Alaska Communications Systems Group, Inc. and Anand Vadapalli entered into on August 5, 2015.	Exhibit 10.1 to Form 8-K (filed August 7, 2015)
10.28*	Employment arrangement between Alaska Communications Systems Group, Inc. and Laurie Butcher.	Exhibit 10.1 to Form 8-K (filed November 5, 2015)
10.29*	The Alaska Communications Systems Group, Inc. 2015 Officer Severance Policy.	Exhibit 10.2 to Form 8-K (filed November 5, 2015)
10.30	Credit Agreement, dated as of September 14, 2015, by and among Alaska Communications Systems Holdings, Inc. as the Borrower, and CoBank, ACB, as Administrative Agent, and ING Capital LLC, as Syndication Agent, the lenders.	Exhibit 10.1 to Form 8-K (filed November 5, 2015)
10.31	Second Lien Credit Agreement, dated as of September 14, 2015, by and among Alaska Communications Systems Holdings, Inc. as the Borrower, and Crystal Financial LLC, as Administrative Agent and the lender.	Exhibit 10.2 to Form 8-K (filed November 5, 2015)
10.32*	2015 Alaska Communications Systems Group, Inc. Non-Employee Director Compensation and Reimbursement Policy.	Exhibit 10.1 to Form 10-Q (filed May 9, 2016)
10.33	Credit Agreement, dated as of March 13, 2017, by and among Alaska Communications, as the borrower, the Company and certain of its direct and indirect subsidiaries, as guarantors, ING Capital LLC, as administrative agent, and the lenders party thereto.	Exhibit 10.1 to Form 8-K (filed March 15, 2017)
16.1	Letter from KPMG LLP to the Securities and Exchange Commission dated April 4, 2016.	Exhibit 16.1 to Form 8-K (filed April 5, 2016)
21.1	Subsidiaries of the Registrant	Filed herewith
23.1	Consent of Moss Adams LLP relating to the audited financial statements of Alaska Communications Systems Group, Inc.	Filed herewith
23.2	Consent of KPMG LLP relating to the audited financial statements of Alaska Communications Systems Group, Inc.	Filed herewith
23.3	Consent of Grant Thornton LLP relating to the audited financial statements of The Alaska Wireless Network, LLC	Filed herewith
31.1	Certification of Anand Vadapalli, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
31.2	Certification of Laurie Butcher, Senior Vice President of Finance, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith

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32.1	Certification of Anand Vadapalli, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
32.2	Certification of Laurie Butcher, Senior Vice President of Finance, pursuant to 18 U.S.C. Section 1350, as adopted to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith

\* Indicates a management contract or compensatory plan or arrangement.

\*\* Confidential treatment of certain portions of this exhibit has been granted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission. Omitted portions have been filed separately with the Commission.

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**SIGNATURES**

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

Date: March 16, 2017

Alaska Communications Systems Group, Inc.

By: /s/ Anand Vadapalli  
Anand Vadapalli  
President and Chief Executive Officer

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/ Anand Vadapalli	President and Chief Executive Officer and Director (Principal Executive Officer)	March 16, 2017
Anand Vadapalli		
/s/ Laurie Butcher	Senior Vice President of Finance (Principal Financial and Accounting Officer)	March 16, 2017
Laurie Butcher		
/s/ Edward J. Hayes, Jr.	Chairman of the Board of Directors	March 16, 2017
Edward J. Hayes, Jr.		
/s/ Margaret L. Brown	Director	March 16, 2017
Margaret L. Brown		
/s/ David W. Karp	Director	March 16, 2017
David W. Karp		

/s/ Peter D. Ley

Director

March 16, 2017

Peter D. Ley

/s/ Brian A. Ross

Director

March 16, 2017

Brian A. Ross

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**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 sheet of Alaska Communications Systems Group, Inc. (the Company ) as of December 31, 2016, and the related consolidated statements of comprehensive income (loss), stockholders' equity (deficit), and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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 the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Alaska Communications Systems Group, Inc. as of December 31, 2016, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Alaska Communications Systems Group, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2017, expressed an unqualified opinion thereon.

/s/ Moss Adams LLP

Spokane, Washington  
March 16, 2017



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Alaska Communications Systems Group, Inc.

We have audited Alaska Communications Systems Group, Inc.'s (the Company) internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company'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, included in the accompanying Management Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included 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, Alaska Communications Systems Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Alaska Communications Systems Group, Inc. as of December 31, 2016, and the consolidated statements of comprehensive income (loss), stockholders' equity (deficit), and cash flows for the year then ended, and our report dated March 16, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ Moss Adams LLP

Spokane, Washington  
March 16, 2017

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**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 sheet of Alaska Communications Systems Group, Inc. and subsidiaries as of December 31, 2015, and the related consolidated statements of comprehensive income (loss), stockholders' equity (deficit), and cash flows for each of the years in the two-year period ended December 31, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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, 2015, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

Anchorage, Alaska  
March 28, 2016

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Consolidated Balance Sheets****December 31, 2016 and 2015****(In Thousands, Except Per Share Amounts)**

	<b>2016</b>	<b>2015</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 21,228	\$ 36,001
Restricted cash	1,917	1,824
Accounts receivable, net	25,062	25,225
Materials and supplies	4,917	4,674
Prepayments and other current assets	5,995	8,068
Total current assets	59,119	75,792
Property, plant and equipment	1,349,899	1,337,098
Less: accumulated depreciation and amortization	(983,050)	(967,776)
Property, plant and equipment, net	366,849	369,322
Deferred income taxes	14,718	16,660
Other assets	1,674	1,827
Total assets	\$ 442,360	\$ 463,601
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Current portion of long-term obligations	\$ 1,973	\$ 3,671
Accounts payable, accrued and other current liabilities	38,180	51,275
Advance billings and customer deposits	4,167	4,513
Total current liabilities	44,320	59,459
Long-term obligations, net of current portion	177,626	185,018
Other long-term liabilities, net of current portion	61,538	65,265
Total liabilities	283,484	309,742
Commitments and contingencies		
Alaska Communications stockholders equity:		
Common stock, \$0.01 par value; 145,000 authorized; 51,477 and 50,530 issued and outstanding at December 31, 2016 and 2015, respectively	515	505
Additional paid in capital	159,474	156,971

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Retained earnings (accumulated deficit)	752	(1,634)
Accumulated other comprehensive loss	(2,910)	(3,086)
Total Alaska Communications stockholders' equity	157,831	152,756
Noncontrolling interest	1,045	1,103
Total stockholders' equity	158,876	153,859
Total liabilities and stockholders' equity	\$ 442,360	\$ 463,601

*See Notes to Consolidated Financial Statements*

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Consolidated Statements of Comprehensive Income (Loss)****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)**

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Operating revenues:			
Operating revenues, non-affiliates	\$ 226,866	\$ 232,242	\$ 307,917
Operating revenues, affiliates		575	6,946
Total operating revenues	226,866	232,817	314,863
Operating expenses:			
Cost of services and sales (excluding depreciation and amortization), non-affiliates	102,137	107,162	123,854
Cost of services and sales (excluding depreciation and amortization), affiliates		4,961	57,116
Selling, general and administrative	70,209	88,389	101,398
Depreciation and amortization	34,690	33,867	32,583
Loss (gain) on disposal of assets, net	321	(46,252)	126
Loss on impairment of goodwill			5,986
Earnings from equity method investments		(3,056)	(35,960)
Total operating expenses	207,357	185,071	285,103
Operating income	19,509	47,746	29,760
Other income and (expense):			
Interest expense	(15,447)	(19,841)	(34,410)
Loss on extinguishment of debt	(336)	(4,878)	
Interest income	26	58	83
Total other income and (expense)	(15,757)	(24,661)	(34,327)
Income (loss) before income tax (expense) benefit	3,752	23,085	(4,567)
Income tax (expense) benefit	(1,499)	(10,200)	1,787
Net income (loss)	2,253	12,885	(2,780)
Less net loss attributable to noncontrolling interest	(133)	(69)	
Net income (loss) attributable to Alaska Communications	2,386	12,954	(2,780)

Other comprehensive income (loss):			
Minimum pension liability adjustment	(294)	(7)	(2,829)
Income tax effect	118	3	1,162
Amortization of defined benefit plan loss	662	936	451
Income tax effect	(272)	(382)	(185)
Interest rate swap marked to fair value	(170)	600	1,543
Income tax effect	70	(245)	(634)
Reclassification of loss on interest rate swaps	106	1,970	1,613
Income tax effect	(44)	(810)	(663)
Total other comprehensive income	176	2,065	458
Total comprehensive income (loss) attributable to Alaska Communications	2,562	15,019	(2,322)
Net loss attributable to noncontrolling interest	(133)	(69)	
Total other comprehensive income attributable to noncontrolling interest			
Total comprehensive loss attributable to noncontrolling interest	(133)	(69)	
Total comprehensive income (loss)	\$ 2,429	\$ 14,950	\$ (2,322)
Net income (loss) per share attributable to Alaska Communications:			
Basic	\$ 0.05	\$ 0.26	\$ (0.06)
Diluted	\$ 0.05	\$ 0.25	\$ (0.06)
Weighted average shares outstanding:			
Basic	51,169	50,247	49,334
Diluted	52,188	51,368	49,334

*See Notes to Consolidated Financial Statements*

Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Consolidated Statements of Stockholders' Equity (Deficit)****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)**

	<b>Alaska Communications Stockholders' Equity</b>						
			<b>Retained Earnings</b>		<b>Accumulated Other Comprehensive Income (Loss)</b>		
	<b>Common Shares</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Other Comprehensive Income (Loss)</b>	<b>Noncontrolling Interest</b>	<b>Stockholders' Equity (Deficit)</b>	
Balance at December 31, 2013	48,680	\$ 487	\$ 152,193	\$ (11,808)	\$ (5,609)	\$	\$ 135,263
Total comprehensive (loss) income				(2,780)	458		(2,322)
Stock compensation			2,511				2,511
Surrender of shares to cover minimum withholding taxes on stock-based compensation			(593)				(593)
Issuance of common stock, pursuant to stock plans, \$.01 par	980	10	257				267
Balance at December 31, 2014	49,660	497	154,368	(14,588)	(5,151)		135,126
Total comprehensive income (loss)				12,954	2,065	(69)	14,950
Stock compensation			2,008				2,008
Excess tax benefit from share-based payments			733				733
Surrender of shares to cover minimum withholding taxes on stock-based compensation			(408)				(408)
Issuance of common stock, pursuant to stock plans, \$.01 par	870	8	270				278
Contributions from noncontrolling interest						1,172	1,172
Balance at December 31, 2015	50,530	505	156,971	(1,634)	(3,086)	1,103	153,859
				2,386	176	(133)	2,429



Total comprehensive income  
(loss)

Stock compensation				2,830					2,830
Extinguishment of convertible note options				(61)					(61)
Excess tax expense from share-based payments				(47)					(47)
Surrender of shares to cover minimum withholding taxes on stock-based compensation				(476)					(476)
Issuance of common stock, pursuant to stock plans, \$.01 par	947	10		257					267
Contributions from noncontrolling interest								75	75
Balance at December 31, 2016	51,477	\$ 515	\$ 159,474	\$	752	\$ (2,910)	\$ 1,045	\$ 158,876	

*See Notes to Consolidated Financial Statements*

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Consolidated Statements of Cash Flows****Years Ended December 31, 2016, 2015 and 2014****(In Thousands)**

	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Cash Flows from Operating Activities:</b>			
Net income (loss)	\$ 2,253	\$ 12,885	\$ (2,780)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	34,690	33,867	32,583
Gain on wireless sale		(48,232)	
Loss on the disposal of assets	321	1,980	126
Loss on impairment of goodwill			5,986
Gain on ineffective hedge adjustment		(737)	(273)
Amortization of debt issuance costs and debt discount	4,046	4,114	5,104
Amortization of ineffective hedge		1,970	1,613
Loss on extinguishment of debt	336	4,878	
Amortization of deferred capacity revenue	(3,436)	(3,011)	(3,795)
Stock-based compensation	2,830	2,008	2,511
Deferred income tax expense (benefit)	1,855	4,883	(2,047)
Charge for uncollectible accounts	378	1,258	3,329
Cash distribution from equity method investments		3,056	35,960
Earnings from equity method investments		(3,056)	(35,960)
Other non-cash expense, net	621	934	431
Income taxes payable	(514)	(351)	
Changes in operating assets and liabilities	(6,127)	(3,865)	8,381
<b>Net cash provided by operating activities</b>	<b>37,253</b>	<b>12,581</b>	<b>51,169</b>
<b>Cash Flows from Investing Activities:</b>			
Capital expenditures	(30,920)	(50,914)	(46,423)
Capitalized interest	(1,077)	(1,558)	(2,810)
Change in unsettled capital expenditures	(8,304)	3,995	(2,003)
Cash received in the acquisition of a business			68
Proceeds on wireless sale		285,160	
Proceeds on sale of assets	2,664	3,140	136
Return of capital from equity investment		1,875	14,073
Net change in restricted cash	(93)	(1,357)	
<b>Net cash (used) provided by investing activities</b>	<b>(37,730)</b>	<b>240,341</b>	<b>(36,959)</b>

Cash Flows from Financing Activities:

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Repayments of long-term debt	(13,421)	(333,961)	(24,419)
Proceeds from the issuance of long-term debt		90,061	
Debt issuance costs	(544)	(4,901)	
Cash paid for debt extinguishment	(150)	(391)	
Cash paid in acquisition of business		(291)	(795)
Cash proceeds from noncontrolling interest	75	250	
Payment of withholding taxes on stock-based compensation	(476)	(408)	(593)
Excess tax (expense) benefit from share-based payments	(47)	733	
Proceeds from the issuance of common stock	267	278	267
Net cash used by financing activities	(14,296)	(248,630)	(25,540)
Change in cash and cash equivalents	(14,773)	4,292	(11,330)
Cash and cash equivalents, beginning of period	36,001	31,709	43,039
Cash and cash equivalents, end of period	\$ 21,228	\$ 36,001	\$ 31,709
Supplemental Cash Flow Data:			
Interest paid	\$ 12,608	\$ 16,101	\$ 31,562
Income taxes paid, net	\$ 205	\$ 4,936	\$ 260

*See Notes to Consolidated Financial Statements*

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

Alaska Communications Systems Group, Inc. ( we , our , us , the Company , ACS or Alaska Communications ), Delaware corporation, through its operating subsidiaries, provides integrated communication services and managed information technology ( IT ) services to business, wholesale and consumer customers in the state of Alaska and beyond using its statewide and interstate telecommunications network.

The accompanying consolidated financial statements are as of December 31, 2016 and 2015 and for the years ended December 31, 2016, 2015 and 2014. They represent the consolidated financial position, results of operations and cash flows of Alaska Communications and the following wholly-owned subsidiaries:

Alaska Communications Systems Holdings, Inc. ( ACS Holdings )

ACS of Alaska, LLC ( ACSAK )

ACS of the Northland, LLC ( ACSN )

ACS of Fairbanks, LLC ( ACSF )

ACS of Anchorage, LLC ( ACSA )

ACS Wireless, Inc. ( ACSW )

ACS Long Distance, LLC ( ACSLD )

ACS Internet, LLC ( ACSI )

ACS Messaging, Inc. ( ACSM )

ACS Cable Systems, LLC ( ACSC )  
Crest Communications Corporation

WCI Cable, Inc.

WCI Hillsboro, LLC

Alaska Northstar Communications, LLC

WCI Lightpoint, LLC

WorldNet Communications, Inc.

Alaska Fiber Star, LLC

TekMate, LLC ( TekMate )

In addition to the wholly-owned subsidiaries, the Company has a fifty percent interest in ACS-Quintillion JV, LLC, a joint venture formed by its wholly-owned subsidiary ACS Cable Systems, LLC and Quintillion Holdings, LLC ( QHL ) in connection with the North Slope fiber optic network. See Note 3 *Joint Venture* for additional information. The Company previously owned a one-third interest in the Alaska Wireless Network, LLC ( AWN ) which is represented in the Company's consolidated financial statements as an equity method investment through February 1, 2015. On February 2, 2015, the Company sold this one-third interest in connection with the sale of its wireless operations. See Note 2 *Sale of Wireless Operations* for additional information.

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

### ***Basis of Presentation***

The consolidated financial statements and notes include all accounts and subsidiaries of the Company in which it maintains a controlling financial interest. Intercompany accounts and transactions have been eliminated. Investments in entities where the Company is able to exercise significant influence, but not control, are accounted for by the equity method. For transactions with entities accounted for under the equity method, any intercompany profits on amounts still remaining are eliminated. Amounts originating from any deferral of intercompany profits are recorded within either the Company's investment account or the account balance to which the transaction specifically relates (e.g., construction of fixed assets). Only upon settlement of the intercompany transaction with a third party is the deferral of the intercompany profit recognized by the Company. The Company has consolidated the financial results of the joint venture with QHL based on its determination that, for accounting purposes, it holds a controlling financial interest in the joint venture and is the primary beneficiary of this variable interest entity. The Company has accounted for and reported QHL's 50% ownership interest in the joint venture as a noncontrolling interest. See Note 3 *Joint Venture* for additional information. Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation.

*Use of Estimates*

The preparation of financial statements in conformity with Generally Accepted Accounting Principles in the United States ( GAAP ) 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 and long-lived assets, the value of derivative instruments, deferred capacity revenue, legal

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

contingencies, stock-based compensation and income taxes. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes is reasonable under the circumstances. Assumptions are adjusted as facts and circumstances dictate. More volatile capital markets, uncertainty on interest rates, and the continuation of low crude oil pricing have combined to increase the uncertainty in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results may differ significantly from those estimates. Changes in those estimates will be reflected in the financial statements of future periods.

***Cash and Cash Equivalents***

For purposes of the Consolidated Balance Sheets and Consolidated 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***

Restricted cash as of December 31, 2016 consists of \$1,917 held in certificates of deposits as required under the terms of certain contracts to which the Company is a party. When the restrictions are lifted, the Company will transfer these funds into its operating accounts.

***Trade Accounts Receivable and Bad Debt Reserves***

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in net cash provided by operating activities in the Consolidated Statements of Cash Flows. The Company does not have any off-balance sheet credit exposure related to its customers. The Company evaluates its bad debt as a single portfolio since most of its subsidiaries primarily operate within Alaska and are subject to the same economic and risk conditions across industry segments and geographic locations. Bad debt reserves against uncollectible receivables are established and incurred during the period. These estimates are derived through an analysis of account aging profiles and a review of historical recovery experience. Receivables are charged off against the allowance when management confirms it is probable amounts will not be collected. Subsequent recoveries, if any, are credited to the allowance. The Company records bad debt expense as a component of Selling, general and administrative expense in the Consolidated Statements of Comprehensive Income (Loss).

***Materials and Supplies***

Materials and supplies are carried in inventory at the lower of moving average cost or market. Cash flows related to the sale of inventory are included in operating activities in the Company's Consolidated Statements of Cash Flows.

***Exit Obligations***

In connection with the decision to sell its wireless operations, the Company incurred certain costs associated with the wind-down of its retail wireless operations that met the criteria for reporting as exit obligations. These costs were incurred in the fourth quarter of 2014 through 2015, and settlement of the liabilities was completed in 2016. The accounting policies for these costs were as follows:

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

Employee termination costs associated with reductions in retail stores, contact center, and other support organizations, and termination costs associated with synergies and future cost reductions resulting from the Company becoming a more focused broadband and managed IT services company were accrued equal to the payout amount, undiscounted due to the short duration, and amortized over the remaining required service period. These termination benefits included costs accounted for under both Accounting Standards Codification ( ASC ) 420, Exit or Disposal Costs Obligations ( ASC 420 ) and ASC 712, Compensation Nonretirement Postemployment Benefits ( ASC 712 ).

Contract termination costs were accrued for retail store leases and a software contract where we incurred a charge to terminate the contract prior to their stated maturity. These costs were measured equal to the actual cost to terminate the contract and were recognized at the date the contract was terminated.

For retail store leases that were vacated, the costs were measured equal to the fair value of the remaining lease payments and recognized when the Company had ceased to use the property.

Costs associated with marking wireless handset and accessory inventory held for sale to fair value were expensed in the fourth quarter of 2014 and are included in Cost of services and sales (excluding depreciation and amortization), non-affiliates in the Company's Consolidated Statement of Comprehensive Income (Loss).

Other associated costs that met the criteria of an exit activity were accrued when incurred.

***Property, Plant and Equipment***

Telephone property, plant and equipment are stated at historical cost of construction including certain capitalized overhead and interest charges. Renewals and betterments of telephone plant are capitalized, while repairs and renewals of minor items are charged to cost of services and sales (excluding depreciation and amortization) as incurred. The Company uses a group composite depreciation method in accordance with industry practice. Under this method, telephone plant, with the exception of land and capital leases, retired in the ordinary course of business, less salvage, is charged to accumulated depreciation with no gain or loss recognized. Non-telephone plant is stated at historical cost including certain capitalized overhead and interest charges, and when sold or retired, a gain or loss is recognized. Depreciation of property is provided on the straight-line method over estimated service lives ranging from

3 to 50 years.

The Company is the lessee of equipment and buildings under capital leases expiring in various years through 2033. 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 shorter of their related lease terms or the estimated productive lives. Amortization of assets under capital leases is included in depreciation and amortization expense.

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. Increases in rental rates are recorded as incurred which approximates the straight-line method.

The Company capitalizes interest charges associated with construction in progress based on a weighted average interest cost calculated on the Company's outstanding debt.

#### ***Asset Retirement Obligations***

The Company records liabilities for obligations related to the retirement and removal of long-lived assets, consisting primarily of batteries and operating leases. The Company records, as liabilities, the estimated fair value of asset retirement obligations on a discounted cash flow basis when incurred, which is typically at the time the asset is installed or acquired. The obligations are conditional on the occurrence of future events. Uncertainty about the timing or settlement of the obligation is factored into the measurement of the liability. Amounts recorded for the related assets are increased by the amount of these obligations. Over time, the liabilities increase due to the change in their present value, the potential changes in assumptions or inputs, and the initial capitalized assets decline as they are depreciated over the useful life of the related assets. The liabilities are extinguished when the asset is taken out of service.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

***Indefeasible Rights of Use***

Indefeasible rights of use ( IRU ) consist of agreements between the Company and a third party whereby one party grants access to a portion of its fiber network to the other party, or receives access to a portion of the fiber network of the other party. The access may consist of individually specified fibers or a specified number of fibers on the network. Certain of the Company's IRU agreements consist of like kind exchanges for which the value of the access given up is determined to be equal to the value of the access received. Cash may or may not be exchanged depending on the terms of the agreement. For IRU agreements in which an equal amount of cash is received and paid and the transaction is determined to not have commercial substance, revenue and expense is not recognized in connection with the cash exchanged. For IRU agreements that are not like kind exchanges and for which the Company receives or pays cash, revenue and expense are recognized over the term of the agreement.

***Non-operating Assets***

The Company periodically evaluates the fair value of its non-current 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 in the Consolidated Statements of Comprehensive Income (Loss).

***Variable Interest Entities***

The Company's ownership interest in ACS-Quintillion JV, LLC is a variable interest entity as defined in ASC 810, Consolidation. The Company consolidated the financial results of this entity based on its determination that, for accounting purposes, it holds a controlling financial interest in, and is the primary beneficiary of, the entity. The Company has accounted for and reported the interest of this entity's other owner as a noncontrolling interest. See Note 3 *Joint Venture* for additional information.

***Equity Method of Accounting***

Investments in entities where the Company is able to exercise significant influence, but not control, are accounted for by the equity method. Under this method, equity investments are carried at acquisition cost, increased by the Company's proportionate share of the investee's comprehensive income, and decreased by the investee's comprehensive losses up to our proportional ownership interest and cash distributions. The Company evaluates its investments in equity method investments for impairment whenever events or changes in circumstances indicate that the carrying

amount may not be recoverable. At December 31, 2016 and 2015, the Company had no equity method investments.

### ***Deferred Capacity Revenue***

Deferred capacity liabilities are established for usage rights on the Company's network provided to third parties. They are established at fair value and amortized to revenue on a straight line basis over the contractual life of the relevant contract. These liabilities include a deferred capacity revenue liability for future services to be provided to General Communications, Inc. ( GCI ) which is amortized over the contract life of up to 30 years.

### ***Goodwill***

The carrying value of the Company's goodwill, net of accumulated impairment, was zero at December 31, 2016 and 2015. See Note 9 *Goodwill and Other Intangible Assets* for additional information. Goodwill is assessed for impairment annually, or more frequently if events or changes in circumstances indicate potential impairment. The Company may first assess qualitative factors to determine whether it is more-likely-than-not that the carrying value of its single reporting unit exceeds its fair value. If this assessment indicates that it is more-likely-than-not that the carrying value of the reporting unit exceeds its fair value, a two-step quantitative assessment will be completed. The first step consists of comparing the carrying value of the reporting unit with its estimated fair value. The Company determines the estimated fair value of its reporting unit utilizing 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 the estimated cost of capital for purposes of determining a discount factor. If the carrying value of the reporting unit exceeds its estimated fair value, the Company will determine the implied fair value of its goodwill and an impairment loss will be recognized to the extent the carrying value of goodwill exceeds the implied fair value.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

***Long-lived Asset Impairment***

Long-lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment annually, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Company will compare the undiscounted cash flows expected to be generated by that asset to its carrying amount. If the carrying amount of the long-lived asset is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying amount exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals. Impairment is displayed under the caption Operating expenses in the Company's Consolidated Statements of Comprehensive Income (Loss).

***Debt Issuance Costs and Discounts***

Debt issuance costs are capitalized and amortized to interest expense using the effective interest method over the term of the related instruments. Debt discounts are accreted to interest expense using the effective interest method. Debt issuance costs and debt discounts are presented as a direct deduction from the carrying amount of debt on the Company's Consolidated Balance Sheet.

***Preferred Stock***

The Company has 5,000 shares of \$0.01 par value preferred stock authorized, none of which were issued or outstanding at December 31, 2016 and 2015.

***Revenue Recognition***

Substantially all recurring non-usage sensitive 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. Revenue is recognized on the sale of equipment upon acceptance by the customer. Certain of the Company's bundled products and services 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 the relative selling price. Prior to February 2, 2015, wireless offerings included wireless devices and service contracts sold together in the Company's stores and agent locations. The revenue for the device and accessories associated with these direct and indirect sales channels were recognized at the time the related wireless device was sold and was classified

as equipment sales. Monthly service revenue from the majority of the Company's customer base is recognized as services are rendered. Revenue earned from the Company's wireless Lifeline customer base was less certain and was therefore recognized on the cash basis as payments were received.

### ***Concentrations of Risk***

Cash is maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits and the Company enters into arrangements to collateralize these amounts with securities of the underlying financial institutions. Generally, these deposits may be redeemed upon demand. The Company has not experienced any losses on such deposits.

The Company also depends on a limited number of suppliers and vendors for equipment and services for its network. The Company's subscriber base and operating results could be adversely affected if these suppliers experience financial or credit difficulties, service interruptions, or other problems.

As of December 31, 2016, approximately 56% of the Company's employees are represented by the International Brotherhood of Electrical Workers, Local 1547 ( "IBEW"). The Master Collective Bargaining Agreement ( "CBA" ) between the Company and the IBEW expired on December 31, 2016. As of the date of this report, negotiations for a new agreement are continuing, and the parties will operate under the terms of the prior agreement until a new contract is in place. The CBA provides the terms and conditions of employment for all IBEW represented employees working for the Company in the state of Alaska and has significant economic impacts on the Company as it relates to wage and benefit costs and work rules that affect our ability to provide superior service to our customers. The Company considered relations with the IBEW to be stable in 2016; however, any deterioration in the relationship with the IBEW would have a negative impact on the Company's operations.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

The Company provides voice, broadband and managed IT services to its customers throughout Alaska. Accordingly, the Company's financial performance is directly influenced by the competitive environment in Alaska, and by economic factors specifically in Alaska. The most significant economic factor is the level of Alaskan oil production and the per barrel price of relevant crude oil. A significant majority of the state's unrestricted revenue comes from taxes assessed upon the production of this resource, and the price of crude oil impacts the level of investment by resource development companies. The drop in crude oil prices during the past three years has resulted in the State of Alaska reducing its spending, which is having a dampening impact on the overall state economy, including declining employment levels in 2016. Other important factors influencing the Alaskan economy include the level of tourism, government spending, and the movement of United States military personnel. Any further deterioration in these factors, particularly over a sustained period of time, would likely have a negative impact on the Company's performance.

As an entity that relies on the Federal Communications Commission (FCC) and state regulatory agencies to provide stable funding sources to provide services in high cost areas, the Company is also impacted by any changes in regulations or future funding mechanisms that are being established by these regulatory agencies. In 2016, 9% of the Company's total revenues were derived from high cost support.

Additionally, the Company considers the vulnerabilities of its network and IT systems to various cyber threats. While the Company has implemented several mitigating policies, technological safeguards and some insurance coverage, it is not possible to prevent every possible threat to its network and IT systems from deliberate cyber related attacks.

***Advertising Costs***

The Company expenses advertising costs as incurred. Advertising expense totaled \$3,460, \$4,065 and \$4,741 in 2016, 2015 and 2014, respectively and is included in Selling, general and administrative expense in the Company's Consolidated Statements of Comprehensive Income (Loss).

***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 basis 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. The Company evaluates tax positions taken or expected to be taken in the course of

preparing its financial statements to determine whether the tax positions are more-likely-than-not of being sustained by the applicable tax authority. The Company records interest and penalties for underpayment of income taxes as income tax expense.

***Taxes Collected from Customers and Remitted to Government Authorities***

The Company excludes taxes collected from customers and payable to government authorities from revenue. Taxes payable to government authorities are presented as a liability on the Consolidated Balance Sheets.

***Regulatory Accounting and Regulation***

Certain activities of the Company are subject to rate regulation by the FCC for interstate telecommunication service and the Regulatory Commission of Alaska ( 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 regulation as a non-dominant interexchange carrier by the FCC for interstate telecommunication services and the RCA for intrastate telecommunication services. Wireless, Internet and other non-common carrier services are not subject to rate regulation.

***Derivative Financial Instruments***

The Company does not enter into derivative contracts for speculative purposes. The Company recognizes all asset or liability derivatives at fair value. The accounting for changes in fair value is contingent on the intended



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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

use of the derivative and its designation as a hedge. Derivatives that are not hedges are 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 (loss) until the hedged transaction is recognized in earnings. 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 on-going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the 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 highly effective, the Company discontinues hedge accounting prospectively. The change in a derivative's fair value related to the ineffective portion of a hedge is immediately recognized in earnings. Amounts recorded to accumulated other comprehensive loss from the date of the derivative's inception to the date of ineffectiveness are amortized to earnings over the remaining term of the hedged item. If the hedged item is settled prior to its originally scheduled date, any remaining accumulated comprehensive loss associated with the derivative instrument is reclassified to earnings. Termination of a derivative instrument prior to its scheduled settlement date may result in charges for termination fees.

***Dividend Policy***

The Company's dividend policy is set by the Company's Board of Directors and is subject to the terms of its 2015 Senior Credit Facilities and the continued current and future performance and liquidity needs of the Company. Dividends on the Company's common stock are not cumulative to the extent they are declared. The Board has not authorized the payment of a dividend since 2012, and has not updated its dividend policy. Effective in the first quarter of 2017, the Company's dividend policy is subject to the terms of its new senior credit facility. See Note 22 *Subsequent Events*.

***Share-based Payments***

***Restricted Stock Units ( RSUs )***

The Company determines the fair value of RSUs based on the number of shares granted and the quoted closing market price of the Company's common stock on the date of grant, discounted for estimated dividend payments that do not accrue to the employee during the vesting period. Compensation expense is recognized over the vesting period and adjustments are charged or credited to expense. RSUs are granted under the Company's 2011 Incentive Award Plan.

*Performance Share Units ( PSUs )*

The Company measures the fair value of each new PSU at the grant date. Adjustments each reporting period are based on changes to the expected achievement of the performance goals or if the PSUs otherwise vest, expire, or are determined by the Compensation Committee of the Company's Board of Directors to be unlikely to vest prior to expiration. Adjustments are charged or credited to expense. Compensation expense is recorded over the expected performance period. PSUs are granted under the Company's 2011 Incentive Award Plan.

*Employee Stock Purchase Plan ( ESPP )*

The Company makes payroll deductions of from 1% to 15% of compensation from employees who elect to participate in the ESPP. A liability accretes during the 6-month offering period and at the end of the offering period (June 30 and December 31), the Company issues the shares from the 2012 Employee Stock Purchase Plan ( 2012 ESPP ). Compensation expense is recorded based upon the estimated number of shares to be purchased multiplied by the discount rate per share.

*Tax Treatment*

Stock-based compensation is treated as a temporary difference for income tax purposes and increases deferred tax assets until the compensation is realized for income tax purposes. To the extent that realized tax benefits exceed the book based compensation, the excess tax benefit is credited to additional paid in capital.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

***Pension Benefits***

***Multi-employer Defined Benefit Plan***

Pension benefits for substantially all of the Company's Alaska-based employees are provided through the Alaska Electrical Pension Fund ( AEPF ). The Company pays a contractual hourly amount based on employee classification or base compensation. The accumulated benefits and plan assets are not determined for, or allocated separately to, the individual employer.

***Defined Benefit Plan***

The ACS Retirement Plan, which is the Company's sole single-employer defined benefit plan and covers a limited number of employees previously employed by a predecessor to one of our subsidiaries, is frozen. The Company recognizes the under-funded status of this plan as a liability on its balance sheet and recognizes changes in the funded status in the year in which the changes occur. The ACS Retirement Plan's accumulated benefit obligation is the actuarial present value, as of the Company's December 31 measurement date, of all benefits attributed by the pension benefit formula. The amount of benefits to be paid depends on a number of future events incorporated into the pension benefit formula, including estimates of the average life of employees or survivors and average years of service rendered. It is measured based on assumptions concerning future interest rates and future employee compensation levels. Unrecognized prior service credits and costs and net actuarial gains and losses are recognized as a component of other comprehensive income (loss), net of tax.

***Defined Contribution Plan***

The Company provides a 401(k) retirement savings plan covering substantially all of its employees. Discretionary company-matching contributions are determined by the Board of Directors.

***Earnings per Share***

The Company computes earnings per share based on the weighted number of shares of common stock and dilutive potential common share equivalents outstanding. This includes all issued and outstanding share-based payments.

***Recently Adopted Accounting Pronouncements***

In the first quarter of 2016, the Company adopted Accountings Standards Update ( ASU ) No. 2015-05, *Intangibles Goodwill and Other Internal-Use Software (Subtopic 350-40), Customer s Accounting for Fees Paid in a Cloud Computing Arrangement* ( ASU 2015-05 ). The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. As provided by ASU 2015-05, the Company adopted the update prospectively to all arrangements entered into or materially modified beginning in 2016. Adoption of ASU 2015-05 did not have a material effect on the Company s consolidated financial statements and related disclosures in the fiscal year ended December 31, 2016.

#### ***Accounting Pronouncements Issued Not Yet Adopted***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ( ASU 2014-09 ). The amendments in ASU 2014-09 require that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB deferred the effective date of ASU 2014-09 from annual periods beginning after December 15, 2016 to annual periods beginning after December 15, 2017. In April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing* ( ASU 2016-10 ). This update provides further guidance on two aspects of Topic 606: (i) identifying performance obligations; and (ii) implementation of licensing guidance. In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606), Narrow-Scope Improvements and Practical*

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

*Expedients* ( ASU 2016-12 ). This update (i) clarifies the objective of the collectability criterion; (ii) permits an entity to exclude amounts collected from customers for all sales and other similar taxes from the transaction price; (iii) specifies that the measurement date for noncash consideration is contract inception; (iv) provides a practical expedient for addressing contract modifications; (v) clarifies the definition of a completed contract for transition purposes; and (vi) clarifies certain retrospective adoption guidance. In December 2016, the FASB issued ASU No. 2016-20, *Revenue from Contracts with Customers (Topic 606), Technical Corrections and Improvements* ( ASU 2016-20 ). This update clarifies or corrects the application of certain aspects of Topic 606 including: (i) impairment testing of contract costs; (ii) disclosure of remaining performance obligations; and (iii) disclosure of revenue recognized from performance obligations satisfied in previous periods. ASU 2016-10, ASU 2016-12 and ASU 2016-20 do not change the core principles of the guidance in Topic 606. Adoption of the new standard is to be applied on a full retrospective basis or modified retrospective basis. The Company's assessment of ASU 2014-09 and subsequent updates is ongoing and is currently expected to be completed during the second or third quarter of 2017. This assessment includes determining the effect of the new standard on the Company's financial statements, accounting systems, business processes, and internal controls. The Company has not yet finalized its assessment of the impact of the new standard on its recognition of revenue. It is currently expected that adoption of the new standard will result in the deferral of certain contract costs, including certain sales commissions, which are currently expensed as incurred. Such deferred costs will be amortized over the period that the associated revenue is recognized. Implementation of required changes to the Company's accounting systems, business processes and internal controls will commence upon completion of the assessment. The Company will adopt ASU 2014-09 effective January 1, 2018 and has not yet selected an adoption method.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ( ASU 2016-02 ). The primary change in GAAP addressed by ASU 2016-02 is the requirement for a lessee to recognize on the balance sheet a liability to make lease payments ( lease liability ) and a right-of-use asset representing its right to use the underlying asset for the lease term. For finance leases, a lessee is required to (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments; (ii) recognize interest on the lease liability separately from amortization of the right-of-use asset; and (iii) classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows. For operating leases, a lessee is required to (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments; (ii) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and (iii) classify all cash payments within operating activities in the statement of cash flows. For leases with a term of twelve months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a

straight-line basis over the lease term. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. ASU 2016-02 also requires qualitative and quantitative disclosures to enable users of the financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation – Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). The amendments in ASU 2016-09 simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Provisions include (i) all excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit in the income statement; (ii) the tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur; (iii) an entity should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period; (iv) excess tax benefits should be classified as an operating activity; (v) an entity may make an accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur; (vi) the

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

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

threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates; and (vii) cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, including interim periods within those years. Adoption will be applied prospectively, retrospectively or using a modified retrospective method as required by the specific provisions. The Company will adopt the provisions of ASU 2016-09 in 2017 and does not currently expect that adoption will have a material effect on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments* (ASU 2016-15). The amendments in this update address eight specific cash flow classification issues for which current GAAP either is unclear or does not include specific guidance, and for which there exists diversity in practice: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted, including adoption in an interim period. Adoption is to be applied using a retrospective transition method to each period presented. The Company is evaluating the effect that ASU 2016-15 will have on its consolidated financial statements and related disclosures, and does not currently expect the effect to be material.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230), Restricted Cash* (ASU 2016-18). The amendments in this update require that the statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts described as restricted cash or restricted cash equivalents. Amounts described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the statement of cash flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. Early adoption is permitted, including adoption in an interim period, and should be applied on a retrospective basis. The Company is evaluating the effect that ASU 2016-18 will have on its consolidated financial statements and related disclosures.

## **2. SALE OF WIRELESS OPERATIONS**

On December 4, 2014, the Company entered into a Purchase and Sale Agreement to sell to GCI, ACSW's interest in the Alaska Wireless Network (AWN) and substantially all the assets and subscribers used primarily in the wireless business of Alaska Communications and its affiliates (the Acquired Assets) (the Wireless Sale).

The Acquired Assets included, without limitation, all the equity interests of AWN owned or held by ACSW, substantially all of Alaska Communication's wireless subscriber assets, including subscriber contracts, and certain network assets at predetermined demarcation points to the cell site locations, including certain fiber strands and associated cell site electronics and microwave facilities and associated electronics. This transaction also includes a capacity agreement with GCI whereby Alaska Communications provides certain capacity from the predetermined demarcation points to a central switch location and, if required, to points outside of Alaska.

The transaction was completed on February 2, 2015, subject to resolution of potential additional purchase price adjustments. After final resolution in the third quarter of 2015 (as described below) of adjustments for certain working capital assets and liabilities, minimum subscriber levels, preferred distributions and other adjustments totaling \$14,840, cash proceeds on the sale were \$285,160, of which \$240,472 was used to pay down the Company's 2010 Senior Secured Credit Facility (2010 Senior Credit Facility). The Company recorded a gain before income tax of \$48,232 in the year ended December 31, 2015.

The two companies entered into a service transition plan in which Alaska Communications continued to provide certain retail and back office services to its previous wireless customers for an interim period, which was



Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****2. SALE OF WIRELESS OPERATIONS (Continued)**

completed on April 17, 2015. This arrangement did not cover the full cost of providing the service. The fair value of these services was \$4,769 and was reported as operating revenue. The fair value of the services exceeded the consideration received for this service by approximately \$522. The \$522 loss was included in the calculation of the gain on the sale.

In May 2015, the Company received a cash payment from GCI of \$1,680 for timely completion of a transition support agreement. The services provided by the Company in connection with this agreement were not consistent with services rendered in the normal course of business. Accordingly, this amount was included in cash proceeds and gain on the sale.

On August 4, 2015, the Company and GCI entered into an agreement to resolve all outstanding issues between the parties associated with the Wireless Sale including finalization of the purchase price adjustments. In the third quarter of 2015, \$7,092 of \$9,000 cash placed in escrow at closing pending resolution of potential additional purchase price adjustments was disbursed to the Company and \$1,680 was disbursed to GCI. The gain on and proceeds from the Wireless Sale described above include the \$7,092 received from escrow in the third quarter of 2015. The remaining \$228 of cash placed in escrow was disbursed to the Company upon timely completion of certain backhaul orders during the fourth quarter of 2015. These backhaul orders consisted of services rendered by the Company in the normal course of business, and the resulting margin was consistent with that typically generated from such services. Accordingly, the \$228 was recorded as revenue.

The following table provides the calculation of the gain:

Consideration:	
Cash	\$ 44,688
Principal payment on 2010 Senior Credit Facility	240,472
Total consideration	285,160
Carrying value of assets and liabilities sold:	
Equity investment in AWN	250,192
Assets and liabilities, net	5,121
Net change in deferred capacity revenue	(18,385)
Total carrying value of assets and liabilities sold	236,928

Gain on disposal of assets

\$ 48,232

In addition to the major elements discussed above, Alaska Communications and its controlled affiliates are restricted from operating a wireless network or providing wireless products or services in Alaska for a period of four years after closing, except for: (a) fixed wireless replacement, (b) WiFi, (c) wireless backhaul and transport, (d) cell site leases and (e) acting as a wireless internet service provider.

As part of the transaction, the Company initiated a plan to sell certain assets associated with realigning operations. These assets included certain handset inventory, which was sold, and retail store leases which were actively marketed for sale to third parties. Upon completion of the service transition plan, the Company accelerated its plan to achieve cost savings related to the wind-down of the wireless business and from the synergies derived from becoming a more focused broadband and managed IT services company. Exit from all retail store locations and the achievement of key cost savings were completed in 2015.

The Company considered the sale of assets to GCI under the guidance of ASC 205-20, Discontinued Operations and concluded that the assets sold did not meet the definition of a component of an entity. The conclusion was based on the determination that the assets did not comprise operations that can be clearly distinguished, either operationally or for financial reporting purposes. The Company has one operating segment and one reporting unit, and although there are revenue streams that are clearly identifiable, the majority of the operating costs are integrated across the operations of its business and cannot be reasonably separated.

Although they did not meet the criteria for classification as held-for-sale, certain other assets and liabilities were impacted by the transaction as follows:

The equity method investment in AWN, valued at \$250,192, was sold to GCI on February 2, 2015.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**2. SALE OF WIRELESS OPERATIONS (Continued)**

The remaining Deferred AWN capacity revenue, which was created during the AWN transaction in 2013 and was being amortized over the 20-year contract life, was removed. This capacity had a carrying value of \$59,672 on February 2, 2015. It was replaced with a new service obligation in the amount of \$41,287 which was recorded at the estimated fair value of the services to be provided to GCI in the future and will be amortized over the new contract life of up to 30 years.

On February 2, 2015, the Company's 2010 Senior Credit Facility was amended resulting in \$240,472 in principal payments and the write-off of associated debt discount and debt issuance costs of \$721 and \$1,907, respectively, in 2015. For additional information on this amendment, see Note 11 *Long-term Obligations*.

Current deferred tax assets of \$84,233 representing Federal and state net operating loss carry forwards and state alternative minimum tax credit carry forwards, and non-current deferred tax liabilities of \$70,577 related to the Company's investment in AWN reversed in 2015 as a result of the Wireless Sale.

In connection with its decision to sell its wireless operations, the Company incurred a number of transaction related and wind-down costs throughout 2015. In addition, costs were incurred in connection with plans associated with synergies and future cost reductions resulting from the Company becoming a more focused broadband and managed IT services company. The costs incurred for wind-down and synergy activities include those associated with workforce reductions, termination of retail store and other contracts, and other associated obligations that meet the criteria for reporting as exit obligations under ASC 420, *Exit or Disposal Cost Obligations* (ASC 420). The Company also incurred costs associated with termination benefits accounted for under ASC 712, *Compensation - Nonretirement Postemployment Benefits* (ASC 712). Significant wind-down costs included contract termination costs associated with retail store leases. These obligations included costs associated with the disposal of capital lease assets and liabilities and costs to vacate operating leases which had a remaining term of approximately 11 years and a remaining contract value of \$2,797 at February 2, 2015. Exit from these leases was complete as of December 31, 2015. Transaction costs included legal, debt amendment, accounting and other costs necessary to consummate the transaction. The Company incurred costs totaling \$13,272 in 2015 associated with the transaction and wind-down activities. These costs included exit costs of \$10,745 presented in the table below and transaction and certain transition costs totaling \$2,527. Of the \$13,272, \$4,893 was recorded to *Cost of services and sales* (excluding depreciation and amortization), non-affiliates and \$8,379 was recorded to *Selling, general and administrative* in the Company's Consolidated Statements of Comprehensive Income (Loss).

The following table summarizes the Company's obligations for exit activities, including costs accounted for under both ASC 420 and ASC 712, as of and for the years ended December 31, 2016, 2015 and 2014:

	<b>Labor Obligations</b>	<b>Contract Terminations</b>	<b>Other Associated Obligations</b>	<b>Total</b>
Balance at December 31, 2013	\$	\$	\$	\$
Charged to expense	490		634	1,124
Paid and/or settled			(634)	(634)
Balance at December 31, 2014	490			490
Charged to expense	6,485	3,966	294	10,745
Paid and/or settled	(5,752)	(3,966)	(294)	(10,012)
Balance at December 31, 2015	1,223			1,223
Credited to expense	(93)			(93)
Paid and/or settled	(1,130)			(1,130)
Balance at December 31, 2016	\$	\$	\$	\$

The exit liability is included in Accounts payable, accrued and other current liabilities on the Company's Consolidated Balance Sheet.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**3. JOINT VENTURE**

In the second quarter of 2015, the Company entered into a series of transactions including the acquisition of a fiber optic network on the North Slope of Alaska and the establishment of a joint venture with QHL. The network enables commercially-available, high-speed connectivity where only high-cost microwave and satellite communications was previously available. Through the Alaska Communications and QHL joint venture, this network has been made available to other telecom carriers in the market. The transactions described below were all entered into concurrently on April 2, 2015 and in contemplation of each of the other transactions.

*Acquisition of Fiber Optic Network*

The Company, through its wholly-owned subsidiary ACS Cable Systems, LLC, acquired a fiber optic cable system (including conduit, licenses, permits and right-of-ways) running from the Kuparuk Operating Center to the Trans-Alaska Pipeline System Pump Station #1 (the Fiber Optic System). The purchase price was \$11,000, \$5,500 of which was paid by the Company at closing and the balance of which was paid on April 7, 2016. The Company sold to the previous owner a 30 year IRU on certain fibers from the Fiber Optic System. The sales price was \$400, all of which was paid at closing. The Company also entered into agreements for the exchange of IRUs, pipeline access, conduit and future capacity, and the prepayment of certain fees and services.

*Transactions with QHL*

The Company sold certain fiber strands from the Fiber Optic System to QHL for \$5,300, \$2,650 of which was paid by QHL at closing and the balance of which was paid on March 31, 2016. The Company and QHL also exchanged 30 year IRU agreements.

*Formation of Joint Venture*

On April 2, 2015, the Company, through its wholly-owned subsidiary ACS Cable Systems, LLC, entered into a joint venture agreement with QHL to form ACS-Quintillion JV, LLC (the Joint Venture) for the purpose of expanding the fiber optic network, and making the network available to other telecom carriers. The Joint Venture may also participate in and facilitate other capital and service initiatives in the telecom industry. The Company and QHL each contributed to the Joint Venture IRUs with a combined value of \$1,844 (\$922 by each party). Each party also contributed cash of \$250. The Company contributed an additional IRU with a value of \$461. In the first quarter of 2016, the Company and QHL executed an amendment to the operating agreement which provides the Company access to 50 percent of the Joint Venture's initial in-field lit capacity in compensation for the Company's contribution of the additional IRU at the Joint Venture's formation. This amendment is effective as of the establishment date of the Joint Venture on April 2, 2015. In the second quarter of 2016, the Company and QHL each made an additional \$75 capital contribution to the Joint Venture. The Company and QHL each hold a 50 percent voting interest in the Joint Venture.

The Company determined that the Joint Venture is a Variable Interest Entity as defined in ASC 810, Consolidation. The Company consolidates the financial results of the Joint Venture based on its determination that, the 50 percent voting interest of each party notwithstanding, for accounting purposes it holds a controlling financial interest in, and is the primary beneficiary of, the Joint Venture. This determination was based on (i) the Company's expected future utilization of certain assets of the Joint Venture in the operation of the Company's business; (ii) the Company engineering, design, installation, service and maintenance expertise in the telecom industry and its existing relationships and presence in the Alaska telecom market are expected to be significant factors in the successful operation of the Joint Venture; and (iii) the Company's role as Joint Venture manager and its right to a management fee equal to a percentage of the Joint Venture's collected gross revenue. There was no gain or loss recognized by the Company on the initial consolidation of the Joint Venture. The Company has accounted for and reported QHL's 50 percent ownership interest in the Joint Venture as a noncontrolling interest.

The table below provides certain financial information about the Joint Venture included on the Company's consolidated balance sheet at December 31, 2016 and 2015. Cash may be utilized only to settle obligations of the Joint Venture. Because the Joint Venture is an LLC, its creditors do not have recourse to the general credit

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****3. JOINT VENTURE (Continued)**

of the Company. Property, plant and equipment, net, at December 31, 2016 reflects a \$461 reduction associated with the capacity granted to the Company in connection with the amendment to the operating agreement discussed above.

	<b>2016</b>	<b>2015</b>
Cash	\$ 67	\$ 359
Property, plant and equipment, net of accumulated depreciation of \$112 and \$26	\$ 2,029	\$ 2,278

The operating results and cash flows of the Joint Venture in the years 2016 and 2015 were not material to the Company's consolidated financial results.

**4. ACCOUNTS RECEIVABLE**

Accounts receivable, net, consists of the following at December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
Retail customers	\$ 17,511	\$ 16,986
Wholesale carriers	4,293	3,391
Other	4,373	6,541
	26,177	26,918
Less: allowance for doubtful accounts	(1,115)	(1,693)
Accounts receivable, net	\$ 25,062	\$ 25,225

Allowance for doubtful accounts consists of the following at December 31, 2016, 2015 and 2014.

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Balance at January 1	\$ 1,693	\$ 2,338	\$ 6,193

Provision for uncollectible accounts	378	1,258	3,329
Charged to other accounts	(13)	8	(2)
Deductions	(943)	(1,911)	(7,182)
Balance at December 31	\$ 1,115	\$ 1,693	\$ 2,338

## 5. CURRENT LIABILITIES

Accounts payable, accrued and other current liabilities consist of the following at December 31, 2016 and 2015:

	2016	2015
Accrued payroll, benefits, and related liabilities	\$ 14,395	\$ 17,362
Accounts payable - trade	13,782	16,057
Note payable, non-interest bearing, due 2016		5,500
Deferred capacity and other revenue	4,502	4,292
Other	5,501	8,064
	\$ 38,180	\$ 51,275

Advance billings and customer deposits consist of the following at December 31, 2016 and 2015:

	2016	2015
Advance billings	\$ 4,136	\$ 4,482
Customer deposits	31	31
	\$ 4,167	\$ 4,513



Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****6. EQUITY METHOD INVESTMENTS**

The Company had no equity method investments at December 31, 2016 and 2015. See Note 2 *Sale of Wireless Operations* for information about the Company's sale of its ownership interest in AWN on February 2, 2015.

***TekMate***

On August 31, 2010, the Company acquired a 49% interest in TekMate for \$2,060. On January 31, 2014, the Company purchased the remaining 51% interest in TekMate for \$1,573, of which \$894 was paid in 2014 and \$679 was paid in 2015.

The Company accounted for the purchase of the remaining 51% interest in TekMate at fair value using the acquisition method. On January 31, 2014, the Company ceased to report TekMate as an equity method investment and consolidated its operations into Alaska Communications Systems Group, Inc.

The following table represents the fair value of the assets acquired and liabilities assumed on January 31, 2014:

Current assets	\$ 1,020
Non-current assets	\$ 370
Current liabilities	\$ 467
Non-current liabilities	\$ 247
Equity	\$ 676

Goodwill on the acquisition, which is 100% deductible for tax purposes, was as follows:

Consideration provided (including fair value of contingent consideration)	\$ 1,181
Fair value of equity method investment	831
<b>Total consideration</b>	<b>2,012</b>
Fair value of assets acquired	1,390
Fair value of liabilities assumed	(714)
<b>Total net assets</b>	<b>676</b>

Goodwill	\$ 1,336
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In the fourth quarter of 2014, the Company determined that its goodwill, including that recorded in connection with the acquisition of TekMate, was fully impaired and recorded an impairment charge totaling \$5,986. See Note 9 *Goodwill and Other Intangible Assets*.

In the period January 1, 2014 to January 31, 2014 TekMate's net income was \$12 and it made cash distributions of \$33 to the Company. At January 31, 2014, undistributed earnings of TekMate were \$0.

Pro forma financial information has been omitted because the acquisition was not material to the Company's historical consolidated financial statements.

### ***AWN FORMATION***

On February 2, 2015, the Company sold its one-third interest in AWN to GCI. See Note 2 *Sale of Wireless Operations* for additional information.

On July 22, 2013, the Company and GCI completed the transactions contemplated by the June 4, 2012 Asset Purchase and Contribution Agreement for the purpose of combining their wireless networks into AWN.

Pursuant to the Contribution Agreement, Alaska Communications sold certain wireless assets to GCI for a cash payment of \$100,000. GCI then contributed these assets, together with GCI's wireless assets, to AWN in exchange for a two-thirds membership interest in AWN. The Alaska Communications Member contributed the Company's wireless assets that were not sold to GCI to AWN in exchange for a one-third membership interest in AWN.

Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****6. EQUITY METHOD INVESTMENTS (Continued)**

At the closing, the parties entered into the First Amended and Restated Operating Agreement of The Alaska Wireless Network, LLC (the Operating Agreement) and other related agreements which governed the ongoing relationship among the parties. Under the terms of the Operating Agreement, AWN was managed by its majority owner, GCI, subject to certain protective rights retained by the Company and representation of one of three seats on AWN's Board. Accordingly, Alaska Communications had the ability to exercise significant influence over AWN and accounted for its investment under the equity method in accordance with ASC 323, Investments—Equity Method and Joint Ventures.

The Operating Agreement provided that Alaska Communications was entitled to a cumulative preferred cash distribution of up to \$12,500 of Adjusted Free Cash Flow, as defined in the agreement, in each of the first eight quarters after closing and \$11,250 in each of the eight quarters thereafter (Alaska Communications' preference period).

A national valuation firm was engaged by the parties to assist in the determination of the fair value of AWN including the preferred distribution and the allocation of the purchase price to the assets and liabilities. This valuation was completed in the second quarter of 2014 and assigned a valuation to the AWN Equity Investment of \$266,000 and to the Deferred AWN Capacity Revenue of \$64,627. The carrying value of the AWN Equity Investment and Deferred AWN Capacity Revenue at December 31, 2014 were \$252,067 and \$59,964, respectively.

The *Deferred AWN capacity revenue* was amortized on a straight-line basis to revenue in the Consolidated Statements of Comprehensive Income (Loss) over the 20-year period for which the Company had contracted to provide service. The Company amortized \$292 and \$3,151 to revenue in the years ended December 31, 2015 and 2014, respectively.

In the second quarter of 2014, the Company received the final valuation report and as a result trued up the value of its capacity contribution to AWN and its pre-tax gain of \$210,873.

The following table represents the calculation of the gain:

Consideration received:	
Investment	\$ 266,000
Cash	100,000
Total consideration received	366,000

Consideration provided:	
Net intangible and tangible assets	90,500
Deferred AWN capacity revenue	64,627
 Total consideration provided	 155,127
 Gain on disposal of assets	 \$ 210,873

In the period January 1 through February 2, 2015, the Company's share of AWN's adjusted free cash flow was \$764 which was received in the first quarter of 2015. In the year ended December 31, 2014, the Company's share of AWN's adjusted free cash flow was \$50,000, of which \$45,833 was received during the period and \$4,167 was paid within the subsequent 12-day contractual period. In the period July 23, 2013 through December 31, 2013, the Company's share of AWN's adjusted free cash flow was \$22,011, of which \$17,844 was received during the period and \$4,167 was paid within the subsequent 12-day contractual period. The Company's equity in the earnings of AWN for the years ended December 31, 2015 and 2014 were \$3,056 and \$35,948 respectively.

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****6. EQUITY METHOD INVESTMENTS (Continued)**

Summarized financial information for AWN is as follows:

	<b>Twelve Months Ended December 31, 2016</b>	<b>January 1 through February 2, 2015</b>	<b>Twelve Months Ended December 31, 2014</b>
Operating revenues	\$	\$ 21,457	\$ 252,864
Gross profit	\$	\$ 15,745	\$ 179,243
Operating income	\$	\$ 9,757	\$ 113,772
Net income	\$	\$ 9,722	\$ 113,404
Adjusted free cash flow <sup>(1)</sup>	\$	\$ 10,805	\$ 106,937

<sup>(1)</sup> Adjusted free cash flow is defined in the Operating Agreement.

AWN was organized as a limited liability corporation and was a flow-through entity for income tax purposes.

**7. FAIR VALUE MEASUREMENTS**

The Company has developed valuation techniques based upon observable and unobservable inputs to calculate the fair value of non-current monetary assets and liabilities. Observable inputs reflect market data obtained from independent sources while unobservable inputs reflect internal market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1- Quoted prices for identical instruments in active markets.

Level 2- Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3- Significant inputs to the valuation model are unobservable.

Financial assets and liabilities are classified within the fair value hierarchy in their entirety based on the lowest level of input that is significant to the fair value measurements. The Company's assessment of the significance of a particular input to the fair value measurements requires judgment and may affect the valuation of the assets and liabilities being measured, as well as their level within the fair value hierarchy.

The fair values of cash equivalents, restricted cash, other short-term monetary assets and liabilities and capital leases approximate carrying values due to their nature. The fair value of the Company's 6.25% Convertible Notes due 2018 ( 6.25% Notes ) Notes of \$91,729 at December 31, 2016, was estimated based on quoted market prices for identical instruments on dates different from the market trade date value (Level 2). The carrying value of the 6.25% Notes at December 31, 2016 was \$91,729. The carrying values of the Company's 2015 Senior Credit Facilities and other long-term obligations of \$90,075 at December 31, 2016 approximate fair value primarily as a result of the stated interest rates of the 2015 Senior Credit Facilities approximating current market rates (Level 2).

### ***Fair Value Measurements on a Recurring Basis***

The following table presents the liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015 at each hierarchical level. There were no transfers into or out of Levels 1 and 2 during 2016.

	December 31, 2016				December 31, 2015			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
<b>Other long-term liabilities:</b>								
Interest rate swaps	\$ 100	\$	\$ 100	\$	\$ 79	\$	\$ 79	\$
<i>Derivative Financial Instruments</i>								

The Company currently uses interest rate swaps to manage variable interest rate risk. At low LIBOR rates, payments under the swaps increase the Company's cash interest expense.

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****7. FAIR VALUE MEASUREMENTS (Continued)**

The outstanding amount of the swaps as of a period end are reported on the balance sheet at fair value, represented by the estimated amount the Company would receive or pay to terminate the swaps. They are valued using models based on readily observable market parameters for all substantial terms of the contracts and are classified within Level 2 of the fair value hierarchy.

As a component of the Company's cash flow hedging strategy and to comply with the terms of the 2015 Senior Credit Facilities, on November 27, 2015, the Company entered into a pay-fixed, receive-floating interest rate swap in the notional amount of \$44,827 with an interest rate of 5.833%, inclusive of a 4.5% LIBOR spread, and a maturity date of December 31, 2017. Hedge designation for this swap was established on December 18, 2015. The change in fair value between the swap's acquisition date and designation date of \$83 was charged to interest expense. Changes in fair value subsequent to the designation date are recorded to accumulated other comprehensive income (loss) and are reclassified to interest expense when the hedged transaction is recognized in earnings. See Note 13 *Accumulated Other Comprehensive Loss*.

The Company's new senior credit facility entered into on March 13, 2017, also requires hedging a portion of the variable rate interest payments under the agreement. The new credit agreement is not expected to impact the effectiveness of the interest rate swap described above. See Note 22 *Subsequent Events*.

In connection with the Company's 2010 Senior Credit Facility, swaps in the notional amounts of \$115,500 and \$77,000 with interest rates of 7.220% and 7.225%, inclusive of a 4.75% LIBOR spread, began on June 30, 2012 and expired on September 30, 2015. On December 4, 2014, upon the announcement of the sale of its wireless operations, \$240,472 of the Company's 2010 Senior Credit Facility was expected to be repaid. Hedge accounting treatment on the interest rate swap in the notional amount of \$115,500 was discontinued because it became possible that the interest payments on which the swap were intended to hedge would not occur. At February 2, 2015, 95.5% or \$110,268 of the \$115,500 swap was deemed ineffective and, therefore, changes in fair value through the swap's expiration on September 30, 2015 were recorded to interest expense. Through December 31, 2015, \$820 was credited to interest expense for the ineffective portion of these swaps.

The following table presents the notional amount, fair value and balance sheet classification of the Company's derivative financial instruments designated as cash flow hedges as of December 31, 2016 and 2015:

	<b>Balance Sheet Location</b>	<b>Notional Amount</b>	<b>Fair Value</b>
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At December 31, 2016:

Interest rate swaps	Other long-term liabilities	\$ 42,750	\$ 100
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At December 31, 2015:

Interest rate swaps	Other long-term liabilities	\$ 44,827	\$ 79
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The following table presents gains and losses before income taxes on the Company's interest rate swaps designated as cash flow hedges for the years ending December 31, 2016, 2015 and 2014.

	2016	2015	2014
(Loss) gain recognized in accumulated other comprehensive loss	\$ (170)	\$ 600	\$ 1,543
Loss reclassified from accumulated other comprehensive loss	\$ (106)	\$ (1,970)	\$ (1,613)
Gain recognized in interest expense (ineffective portion and amount excluded from effectiveness testing)	\$	\$ 737	\$

The following table presents a reconciliation of the carrying value of the Company's interest rate swaps, which are included in Other long-term liabilities, net of current portion on the balance sheet, as of and for the years ending December 31, 2016 and 2015:



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	<b>2016</b>	<b>2015</b>
Balance at January 1	\$ 79	\$ 1,416
Reclassified from other long-term liabilities to accumulated other comprehensive loss	170	(600)
Change in fair value credited to interest expense	(149)	(737)
Balance at December 31	\$ 100	\$ 79

***Fair Value Measurements on a Non-Recurring Basis******Deferred Capacity Revenue***

As discussed in Note 2 *Sale of Wireless Operations*, the Company entered into an agreement to provide wholesale services to GCI on February 2, 2015. A national valuation firm was engaged to assist management in the determination of the fair value of the obligation which was determined to be \$41,287 at February 2, 2015. The obligation is amortized to revenue on a straight line basis over the contract lives of 10 to 30 years. The total carrying value of the service obligation was \$37,326 and \$39,409 at December 31, 2016 and 2015, respectively, and is included in Other long-term liabilities, net of current portion and Accounts payable, accrued and other current liabilities on the Consolidated Balance Sheet.

The following table describes the valuation techniques used to measure the fair value of the service obligation at February 2, 2015 and the significant unobservable inputs and values for those inputs:

<b>Description</b>	<b>Estimated Fair Value</b>	<b>Valuation Technique</b>	<b>Level 3 Unobservable Inputs</b>	<b>Significant Input Values</b>
Deferred Capacity Revenue	\$ 41,287	Cost/Replacement Value and Discounted Cash Flow	Weighted Average Cost of Capital	11.00%
			Cost trend factor	1% - 4%
			Estimated % used by GCI	1% - 100%

Historical cost of underlying assets    Actual cost

*Other Items*

As discussed in Note 3 *Joint Venture*, the Company entered into agreements in connection with the acquisition of the fiber optic network on the North Slope of Alaska and the establishment of the joint venture with QHL. These transactions included the exchange of certain assets and liabilities, all of which were established at fair value on the date of the transactions.

The following table provides the fair value and describes the valuation techniques used to measure the fair value of the assets and liabilities recorded by the Company as of April 2, 2015, including those recognized through consolidation of the Joint Venture, and the significant unobservable inputs:

<b>Description</b>	<b>Estimated Fair Value</b>	<b>Valuation Technique</b>	<b>Level 3 Unobservable Inputs</b>
IRU Assets	\$ 2,304	Cost	Historical cost of underlying assets
IRU Obligations	\$ 4,153	Cost	Historical cost of underlying assets

The carrying value of these items at December 31, 2016 and 2015 was as follows:

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	<b>2016</b>	<b>2015</b>
IRU Assets	\$ 2,196	\$ 2,278
IRU Obligations	\$ 4,027	\$ 4,112

Other than as described below and in Note 9 *Goodwill and Other Intangible Assets*, no impairment of long-lived assets was recognized during 2016, 2015 or 2014. In 2014, the Company recorded a charge of \$435 to adjust its inventory held-for-sale at December 31, 2014 to fair value using Level 2 inputs.

**8. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consist of the following at December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>	<b>Useful Lives</b>
Land, buildings and support assets*	\$ 197,999	\$ 198,485	3 - 42
Central office switching and transmission	383,809	381,511	4 - 12
Outside plant cable and wire facilities	734,786	722,582	16 - 50
Other	7,101	5,207	3 - 5
Construction work in progress	26,204	29,313	
	1,349,899	1,337,098	
Less: accumulated depreciation and amortization	(983,050)	(967,776)	
Property, plant and equipment, net	\$ 366,849	\$ 369,322	

\* No depreciation charges are recorded for land.

Capitalized interest associated with construction in progress for the years ended December 31, 2016, 2015, and 2014 was \$1,077, \$1,558, and \$2,810, respectively. The capitalization rate used was based on a weighted average of the Company's long term debt outstanding, and for the years ended December 31, 2016, 2015, and 2014 was 6.48%, 6.78%, and 8.28%, respectively.

The following is a summary of property, including leasehold improvements, held under capital leases included in the above property, plant and equipment at December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
Land, buildings and support assets	\$ 14,983	\$ 14,694
Less: accumulated depreciation and amortization	(7,422)	(6,674)
<b>Property held under capital leases, net</b>	<b>\$ 7,561</b>	<b>\$ 8,020</b>

Amortization of assets under capital leases included in depreciation expense for the years ended December 31, 2016, 2015, and 2014 was \$1,149, \$1,316 and \$1,832, respectively. Future minimum lease payments, including interest, under these leases for the next five years and thereafter are as follows:

2017	\$ 634
2018	525
2019	310
2020	318
2021	327
Thereafter	4,508
	6,622
Interest	(3,297)
	<b>\$ 3,325</b>

The Company leases various land, buildings, right-of-ways and personal property under operating lease

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agreements. Rental expense under operating leases for the years ended December 31, 2016, 2015 and 2014 was \$7,787, \$11,439 and \$8,782, respectively. Rental expense in 2015 included termination charges of \$3,966 for leases terminated in connection with the Company's sale of its Wireless operations. See Note 2 *Sale of Wireless Operations*.

Future minimum payments under these leases, including month to month rentals which are probable of renewal, for the next five years and thereafter are as follows:

2017	\$ 7,634
2018	6,645
2019	5,936
2020	4,589
2021	4,241
Thereafter	21,459
	<b>\$ 50,504</b>

**9. GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill is assessed for impairment annually, or more frequently if events or changes in circumstances indicate potential impairment. As of December 31, 2016 and 2015, the Company's goodwill was fully impaired or retired.

In the third quarter of 2013, the Company performed an assessment of its goodwill and bifurcated the balance between the business sold to AWN and the business retained. Upon completion of the AWN transaction the \$4,200 of goodwill assigned to the business sold was retired.

In the first quarter of 2014, the Company purchased the remaining 51% interest in TekMate and recorded \$1,336 of goodwill.

In the fourth quarter of 2014 the Company conducted two assessments of goodwill – its annual assessment and an assessment upon the announcement of its sale of Wireless operations which constituted a triggering event. The Company utilized reports from third party valuation experts to determine the estimated fair value of its reporting unit. These reports utilized many methodologies, but primarily relied on a discounted cash flow valuation technique.

Significant estimates used in the valuation included estimates of future cash flows, both future short-term and long-term growth rates and the estimated cost of capital for purposes of determining a discount factor. The Company compared the results of the estimated fair value to other market approaches and comparable public and private company analysis and found the estimated fair value to be reasonable. The Company also performed a reconciliation of its estimated fair value to its market capitalization, based on its recent publically traded stock price. This analysis indicated a potential impairment as the calculated value was less than the book value. For accounting purposes, the Company utilized the fair value indicated by market capitalization, thereby concluding that the carrying value of its single reporting unit exceeded its fair value. Accordingly, the Company performed step two of the goodwill impairment analysis. After measuring the fair value of the reporting unit's assets and liabilities, the implied fair value of goodwill was determined to be zero. Consequently, the Company determined that the goodwill was fully impaired and recorded an impairment charge of \$5,986 for the year ended December 31, 2014.

The gross carrying amount of goodwill, including that related to the acquisition of TekMate and excluding the goodwill retired in connection with the AWN transaction, was \$35,539 at December 31, 2016 and 2015. The accumulated impairment loss was \$35,539 at December 31, 2016 and 2015.

In connection with the AWN transaction in 2013, all of the Company's other intangible assets were sold or contributed to AWN. The Company no longer holds any indefinite-lived intangible assets.

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The Company's asset retirement obligation is included in Other long-term liabilities, net of current portion on the Consolidated Balance Sheet and represents the estimated obligation related to the removal and disposal of certain property and equipment in both leased and owned properties.

The following table provides the changes in the asset retirement obligation:

	<b>2016</b>	<b>2015</b>
Balance at January 1	\$ 3,429	\$ 4,055
Asset retirement obligation	159	254
Accretion expense	182	179
Settlement of obligations	(62)	(106)
Revisions in estimated cash flows		(953)
Balance at December 31	\$ 3,708	\$ 3,429

**11. LONG-TERM OBLIGATIONS**

On March 13, 2017, the Company entered into a new senior credit facility. See Note 22 *Subsequent Events*. Consummation of this agreement prior to issuance of the Company's financial statements demonstrated the Company's intent and ability to refinance a portion of its current obligations in accordance with ASC 470 Debt. Current maturities under the Company's 2015 Senior Credit Facilities totaling \$4,000 at December 31, 2016 were effectively replaced by principal payments totaling \$1,650 under the new senior credit facility. Accordingly, current portion of long-term obligations in the amount of \$2,350 was reclassified to long-term obligations at December 31, 2016. The Consolidated Balance Sheet and schedule of long-term obligations at December 31, 2016, and the schedule of maturities of long-term obligations reflect this reclassification only, and do not reflect all changes in debt maturities resulting from this transaction.

Long-term obligations consist of the following at December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
2015 senior secured credit facilities due 2018	\$ 86,750	\$ 89,750
Debt issuance costs	(1,738)	(3,406)

6.25% convertible notes due 2018	94,000	104,000
Debt discount	(2,271)	(4,641)
Debt issuance costs	(467)	(1,010)
Capital leases and other long-term obligations	3,325	3,996
Total debt	179,599	188,689
Less current portion	(1,973)	(3,671)
Long-term obligations, net of current portion	\$ 177,626	\$ 185,018

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****11. LONG-TERM OBLIGATIONS (Continued)**

As of December 31, 2016, the Company had no amounts outstanding under the \$10,000 revolving credit facility component of its 2015 Senior Credit Facilities.

The aggregate maturities of long-term obligations for each of the next five years and thereafter at December 31, 2016, are as follows:

2017	\$ 1,973
2018	179,336
2019	39
2020	52
2021	67
Thereafter	2,608
	<b>\$ 184,075</b>

***2015 Senior Credit Facilities***

Proceeds from the issuance of the new senior credit facility will be used to repay in full the Company's 2015 Senior Credit Facility. See Note 22 *Subsequent Events*.

On September 14, 2015 (the *Closing Date*), the Company entered into a combined \$100,000 of senior secured financing, including term loans totaling \$90,000 and a \$10,000 revolving credit facility (the *2015 Senior Credit Facilities*). The facilities consist of a \$65,000 first lien term loan and a \$10,000 revolving credit facility (the *First Lien Facility*) and a \$25,000 second lien term loan (the *Second Lien Facility*) (together the *2015 Senior Credit Agreements* or *Agreements*). The Company utilized proceeds from the 2015 Senior Credit Facilities and cash on hand to repay in full its 2010 Senior Credit Facility, repurchase a portion of its 6.25% Notes and fund transaction fees and expenses associated with the 2015 Senior Credit Facilities totaling \$3,907, which were deferred and will be charged to interest expense over the terms of the Agreements. Repayment of the 2010 Senior Credit Facility, including accrued interest and fees, totaled \$81,526. The Company recorded a loss of \$1,312 on the extinguishment, including the write off of unamortized discounts and debt issuance costs, and third-party fees. The 2010 Senior Credit Facility was due in 2016.

The term loan component of the First Lien Facility bears interest at LIBOR plus 4.5% per annum, with a LIBOR minimum of 1.0%. Draws on the revolving credit component of the First Lien Facility bear interest at LIBOR plus

4.5%, with a LIBOR minimum of 1.0% and a commitment fee of 0.25% on the average daily unused portion. The revolving credit component of the First Lien Facility was undrawn as of December 31, 2016. The Second Lien Facility bears interest at LIBOR plus 8.5% per annum, with a LIBOR minimum of 1.0%. At current LIBOR rates, the weighted interest rate on the term loan components of the 2015 Senior Credit Facilities is 6.59%.

Unless extended as described below, quarterly principal payments on the term loan component of the First Lien Facility were \$250 in the fourth quarter of 2015, \$750 in each quarter of 2016, and \$1,000 in each quarter of 2017. The remaining principal balance, including any amounts outstanding under the revolving credit facility, is due in its entirety on January 2, 2018. Unless extended as described below, the Second Lien Facility is due in its entirety on March 3, 2018, and may be prepaid in whole or in part at the Company's option prior to maturity.

The First Lien Facility may be extended to June 30, 2020 and the Second Lien Facility may be extended to September 30, 2020 if the Company (i) has refinanced or repurchased its 6.25% Notes such that no more than \$30,000 of principal amount is outstanding (with cash available for their repayment at maturity) and any replacement notes have a maturity date not earlier than December 31, 2020, (ii) has achieved certain liquidity requirements, and (iii) is otherwise compliant with the terms of the 2015 Senior Credit Facilities. In the event the 2015 Senior Credit Facilities are extended, the quarterly principal payments on the term loan component of the First Lien Facility subsequent to 2017 would be \$1,250 in each quarter of 2018, and \$1,500 in each quarter of 2019 and the first quarter of 2020. The remaining principal balance, including any amounts outstanding under the revolving credit facility, would be due in its entirety on June 30, 2020. The Second Lien Facility would be due in its entirety on September 30, 2020, and may be prepaid in whole or in part at the Company's option prior to maturity.

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**11. LONG-TERM OBLIGATIONS (Continued)**

The obligations under the 2015 Senior Credit Facilities are secured by perfected first and second line priority security interests in substantially all of the Company's and its direct and indirect subsidiary's tangible and intangible assets, subject to certain agreed exceptions.

The 2015 Senior Credit Facilities contain customary representations, warranties and covenants, including covenants limiting the incurrence of debt and the payment of dividends. Financial covenants (i) impose maximum net total leverage and senior leverage to annual Consolidated EBITDA ratios, and (ii) require a minimum annual Consolidated EBITDA to debt service coverage obligations ratio. All terms are defined in the Agreements. Payment of cash dividends and repurchase of the Company's common stock is not permitted until such time that the Company's net total leverage ratio is not greater than 2.75 to 1.00. As of December 31, 2016, the Company's net total leverage ratio was higher than 2.75 to 1.00.

The 2015 Senior Credit Facilities provide for events of default customary for credit facilities of this type, including non-payment defaults on other debt, misrepresentation, breach of covenants, representations and warranties, change of control, and insolvency and bankruptcy. Upon the occurrence of an event of default, and for so long as it continues, the Administrative Agent upon request of the Required Lenders (both as defined in the Agreements) may increase the interest rate then in effect on all outstanding obligations by 2.0%. Upon an event of default relating to insolvency, bankruptcy or receivership, the amounts outstanding under the 2015 Senior Credit Facilities will become immediately due and payable. Upon the occurrence and continuation of any other event of default, the Administrative Agent, upon request of the Required Lenders, may accelerate payment of all obligations.

As a component of the Company's cash flow hedging strategy and to comply with the terms of the 2015 Senior Credit Facilities, on November 27, 2015, the Company entered into a pay-fixed, receive-floating interest rate swap in the notional amount of \$44,827 with an interest rate of 5.833%, inclusive of a 4.5% LIBOR spread, and a maturity date of December 31, 2017. Hedge designation for this swap was established on December 18, 2015. The change in fair value between the swap's acquisition date and designation date of \$83 was charged to interest expense. Changes in fair value subsequent to the designation date were recorded to accumulated other comprehensive income (loss). See Note 7 *Fair Value Measurements* for additional information.

***6.25% Convertible Notes due 2018***

Pursuant to the 2017 Senior Credit Facility, the Company intends to commence a tender offer for its outstanding 6.25% Notes. See Note 22 *Subsequent Events*.

On May 10, 2011, the Company closed the sale of \$120,000 aggregate principal amount of its 6.25% Notes to certain initial purchasers in a private placement. The 6.25% Notes are fully and unconditionally guaranteed ( Note Guarantees ), on a joint and several unsecured basis, by all of the Company's existing subsidiaries, other than its license subsidiaries, and certain of the Company's future domestic subsidiaries ( Guarantors ). The 6.25% Notes pay interest semi-annually on May 1 and November 1 at a rate of 6.25% per year and will mature on May 1, 2018.

The 6.25% Notes will be convertible at an initial conversion rate of 97.2668 shares of common stock per \$1,000 principal amount of the 6.25% Notes, which is equivalent to an initial conversion price of approximately \$10.28 per share of common stock. The Company may not redeem the 6.25% Notes prior to maturity.

Beginning on February 1, 2018, the 6.25% Notes will be convertible by the holder at any time until 5:00 p.m., New York City time, on the second scheduled trading-day immediately preceding the stated maturity date. Given that the Company's current share price is well below \$10.28, we do not anticipate that there will be a conversion into equity.

Prior to February 1, 2018, the holder may convert the 6.25% Notes:

During any fiscal quarter beginning after June 30, 2011 following any previous fiscal quarter in which the trading price of the Company's common stock equals or exceeds 130% of the conversion price of the 6.25% Notes for at least 20 trading-days during the last 30 trading-days of the previous fiscal quarter;

During any five business day period following any five trading-day period in which the trading price of the 6.25% Notes is less than 98% of parity value on each day of that five trading-day period; and

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**11. LONG-TERM OBLIGATIONS (Continued)**

Upon the occurrence of certain significant corporate transactions, holders who convert their 6.25% Notes, in connection with a change of control, may be entitled to a make-whole premium in the form of an increase in the conversion rate. In addition, upon a change in control, liquidation, dissolution or delisting, the holders of the 6.25% Notes may require the Company to repurchase for cash all or any portion of their 6.25% Notes for 100% of the principal amount plus accrued and unpaid interest.

As of December 31, 2016, none of the conditions allowing holders of the 6.25% Notes to convert, or requiring the Company to repurchase the 6.25% Notes, had been met.

Additionally, the 6.25% Notes contain events of default which, if they occur, entitle the holders of the 6.25% Notes to declare them to be immediately due and payable. Those events of default include: (i) payment defaults on either the notes themselves or other large obligations; (ii) failure to comply with the terms of the notes; and (iii) most bankruptcy proceedings.

The 6.25% Notes are unsecured obligations, subordinated in right of payment to the Company's obligations under its 2015 Senior Credit Facilities as well as certain hedging agreements within the meaning of the Company's 2015 Senior Credit Facilities. The 6.25% Notes also rank equally in right of payment with all of the Company's other existing and future senior indebtedness and are senior in right of payment to all of the Company's future subordinated obligations. The Note Guarantees are subordinated in right of payment to the Guarantors' obligations under the Company's 2015 Senior Credit Facilities as well as certain hedging agreements within the meaning of the Company's 2015 Senior Credit Facilities.

Convertible debt instruments that may be settled in cash upon conversion at the Company's option, including partial cash settlement, must be accounted for by bifurcating the liability and equity components of the instruments in a manner that reflects the entity's non-convertible debt borrowing rate when interest cost is recognized in subsequent periods. The Company applied this rate to the \$120,000 6.25% Notes, bifurcating the notes into the liability portion and the equity portion attributable to the conversion feature of the notes. In doing so, the Company used the discounted cash flow approach to value the debt portion of the notes. The cash flow stream from the coupon interest payments and the final principal payment were discounted at 8.61% to arrive at the valuations. The Company used 8.61% as the appropriate discount rate after examining the interest rates for similar instruments issued in the same time frame for similar companies without the conversion feature. The equity component of the 6.25% Notes was \$8,500, net of a tax benefit of \$5,931.

The Company's Board of Directors has authorized the issuance of up to 4,700 common shares for the repurchase of its convertible notes. In the third quarter of 2013, the Company delivered and issued 698 and 1,203 common shares in exchange for the retirement of \$2,500 and \$3,500, respectively, aggregate principal amount of 6.25% Notes. This

Board of Directors authorization expired December 31, 2013.

On January 29, 2016, the Company repurchased a portion of its 6.25% Notes in the total principal amount of \$10,000 for cash consideration of \$9,750. The net cash settlement of \$10,053 included accrued interest and transaction fees totaling \$303. The Company recorded a loss on extinguishment of debt of \$336, including the write off of unamortized discounts and debt issuance costs and the payment of third-party fees, and net of the repurchase discount of \$250 and the amount attributable to the equity component.

In the third quarter of 2015, the Company utilized proceeds from its 2015 Senior Credit Facilities described above and cash on hand to repurchase a portion of its 6.25% Notes in the total principal amount of \$10,000. The total cash settlement of \$10,572 included accrued interest, transaction fees and premium. The Company recorded a loss of \$938 on the extinguishment of this debt, including the write off of unamortized discounts and debt issuance costs, third-party fees and premium.

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The following table provides selected data regarding the 6.25% Notes as of December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
Net carrying amount of the equity component	\$ 6,416	\$ 7,099
Principal amount of the convertible notes	\$ 94,000	\$ 104,000
Unamortized debt discount	\$ 2,271	\$ 4,641
Amortization period remaining	16 months	28 months
Net carrying amount of the convertible notes	\$ 91,729	\$ 99,359

The following table details the interest components of the 6.25% Notes contained in the Company's Consolidated Statements of Comprehensive Income (Loss) for the year ended December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
Coupon interest expense	\$ 5,928	\$ 6,947
Amortization of the debt discount	2,370	2,601
Total included in interest expense	\$ 8,298	\$ 9,548

***Capital Leases and Other Long-term Obligations***

The Company is a lessee under various capital leases and other financing agreements totaling \$3,325 and \$3,996 with a weighted average interest rate of 8.97% and 8.36% at December 31, 2016 and 2015, respectively and have maturities through 2033.

***Debt Issuance Costs***

The Company incurred debt issuance costs totaling \$3,907 associated with its 2015 Senior Credit Facilities which were deferred and will be amortized to interest expense over the terms of the Agreements. Amortization of debt issuance costs were \$2,214, \$3,960 and \$2,460 in the years ended December 31, 2016, 2015 and 2014, respectively. Amortization of debt issuance costs included \$109 and \$2,446 classified as loss on extinguishment of debt in 2016 and 2015, respectively.

**Debt Discounts**

Accretion of debt discounts charged to interest expense or loss on extinguishment of debt in 2016, 2015 and 2014, totaled \$2,370, \$4,641 and \$2,644, respectively. Accretion of debt discounts included \$430 and \$2,041 classified as loss on extinguishment of debt in 2016 and 2015, respectively.

**12. OTHER LONG-TERM LIABILITIES**

Other long-term liabilities consist of the following at December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
Deferred GCI capacity revenue, net of current portion	\$ 35,255	\$ 37,338
Other deferred IRU capacity revenue, net of current portion	15,697	17,009
Other deferred revenue, net of current portion	2,202	2,224
Other	8,384	8,694
	<b>\$ 61,538</b>	<b>\$ 65,265</b>

Amortization of deferred revenue included in the Consolidated Statements of Comprehensive Income (Loss) was \$7,010, \$5,827 and \$6,531 in the years ended December 31, 2016, 2015 and 2014, respectively.



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The following table summarizes the activity in accumulated other comprehensive (loss) income for the years ended December 31, 2016 and 2015:

	<b>Defined Benefit Pension Plans</b>	<b>Interest Rate Swaps</b>	<b>Total</b>
Balance at December 31, 2014	\$ (3,639)	\$ (1,512)	\$ (5,151)
Other comprehensive (loss) income before reclassifications	(4)	355	351
Reclassifications from accumulated comprehensive loss to net income	554	1,160	1,714
Net other comprehensive income	550	1,515	2,065
Balance at December 31, 2015	(3,089)	3	(3,086)
Other comprehensive loss before reclassifications	(176)	(100)	(276)
Reclassifications from accumulated comprehensive loss to net income	390	62	452
Net other comprehensive income (loss)	214	(38)	176
Balance at December 31, 2016	\$ (2,875)	\$ (35)	\$ (2,910)

The following table summarizes the reclassifications from accumulated other comprehensive (loss) income to net income (loss) for the years ended December 31, 2016, 2015, and 2014, respectively:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Amortization of defined benefit plan pension items: <sup>(1)</sup>			
Amortization of loss <sup>(2)</sup>	\$ 662	\$ 936	\$ 451
Income tax effect	(272)	(382)	(185)
After tax	390	554	266

Amortization of loss on interest rate swap: <sup>(3)</sup>			
Reclassification to interest expense	106	1,970	1,613
Income tax effect	(44)	(810)	(663)
After tax	62	1,160	950
Total reclassifications net of income tax	\$ 452	\$ 1,714	\$ 1,216

- (1) See Note 14 *Retirement Plans* for additional information regarding the Company's pension plans.
- (2) Included in Selling, general and administrative expense on the Company's Consolidated Statements of Comprehensive Income (Loss).
- (3) See Note 7 *Fair Value Measurements* for additional information regarding the Company's interest rate swaps. The estimated amount of accumulated other comprehensive loss to be reclassified to interest expense within the next twelve months is \$76.

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****14. RETIREMENT PLANS*****Multi-employer Defined Benefit Plan***

Pension benefits for substantially all of the Company's Alaska-based employees are provided through the AEPF. 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 following table provides additional information about the AEPF multi-employer pension plan.

Plan name	Alaska Electrical Pension Plan		
Employer Identification Number	92-6005171		
Pension plan number	001		
Pension Protection Act zone status at the plan's year-end:			
December 31, 2016	Green		
December 31, 2015	Green		
Plan subject to funding improvement plan	No		
Plan subject to rehabilitation plan	No		
Employer subject to contribution surcharge	No		
	Greater than 5% of Total Contributions to the Plan		
Company contributions to the plan for the year ended:			
December 31, 2016	\$	7,517	Yes
December 31, 2015	\$	7,968	Yes
December 31, 2014	\$	8,626	Yes
Name and expiration date of collective bargaining agreements requiring contributions to the plan:			
Collective Bargaining Agreement Between Alaska Communications Systems and Local Union 1547 IBEW			
(1)	December 31, 2016		

Outside Agreement Alaska Electrical Construction  
between Local Union 1547 IBEW and Alaska Chapter  
National Electrical Contractors Association Inc.

September 30, 2017

Inside Agreement Alaska Electrical Construction  
between Local Union 1547 IBEW and Alaska Chapter  
National Electrical Contractors Association Inc.

October 31, 2019

Special Agreement Providing for the Coverage of  
Certain Non-bargaining Unit Employees <sup>(2)</sup>

December 31, 2016

- (1) As of the date of this report, negotiations for a new agreement are in process. The parties are operating under the terms of the prior agreement until a new contract is in place.
- (2) This agreement runs concurrently with the Collective Bargaining Agreement Between Alaska Communications Systems Holding, Inc. and Local Union 1547 IBEW. As of the date of this report, the parties are operating under the terms of the prior agreement until a new contract is in place.

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****14. RETIREMENT PLANS (Continued)**

The Company cannot accurately project any change in the plan status in future years given the uncertainty of economic conditions or the effect of actuarial valuations versus actual performance in the market. Minimum required future contributions to the AEPF are subject to the number of employees in each classification and/or base compensation of employees in future years.

***Defined Contribution Plan***

The Company 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. The Company made a \$186, \$187 and \$213 matching contribution in 2016, 2015 and 2014 respectively.

***Defined Benefit Plan***

The Company has a separate defined benefit plan that covers certain employees previously employed by Century Telephone Enterprise, Inc. ( CenturyTel Plan ). This plan was transferred to the Company in connection with the acquisition of CenturyTel's Alaska properties, whereby assets and liabilities of the CenturyTel Plan were transferred to the ACS Retirement Plan ( Plan ) on September 1, 1999. Accrued benefits under the Plan were determined in accordance with the provisions of the CenturyTel Plan and upon completion of the transfer, covered employees ceased to accrue benefits under the CenturyTel Plan. On November 1, 2000, the Plan was amended to conform early retirement reduction factors and various other terms to those provided by the AEPF. 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, as amended ( ERISA ). The Company uses a December 31 measurement date for the Plan. The Plan is not adequately funded under ERISA at December 31, 2016. The Company contributed \$798 to the Plan in 2016, \$779 in 2015 and \$898 in 2014. The Company plans to contribute approximately \$929 to the Plan in 2017 and management is also estimating what additional contributions the Company may be required to make in subsequent years in the event the value of the Plan's assets remain volatile or decline.

The following is a calculation of the funded status of the ACS Retirement Plan using beginning and ending balances for 2016 and 2015 for the projected benefit obligation and the plan assets:

	2016	2015
Change in benefit obligation:		

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Benefit obligation at beginning of year	\$ 16,094	\$ 17,234
Interest cost	668	666
Actuarial loss (gain)	55	(754)
Benefits paid	(1,035)	(1,052)
Benefit obligation at end of year	15,782	16,094
Change in plan assets:		
Fair value of plan assets at beginning of year	11,202	11,570
Actual return on plan assets	428	(95)
Employer contribution	798	779
Benefits paid	(1,035)	(1,052)
Fair value of plan assets at end of year	11,393	11,202
Funded status	\$ (4,389)	\$ (4,892)

The Plan's projected benefit obligation equals its accumulated benefit obligation. The 2016 and 2015 liability balance of \$4,389 and \$4,892 respectively, is recorded on the Consolidated Balance Sheets in Other long-term liabilities.

Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****14. RETIREMENT PLANS (Continued)**

The following table presents the net periodic pension expense for the Plan for 2016, 2015 and 2014:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Interest cost	\$ 668	\$ 666	\$ 664
Expected return on plan assets	(373)	(659)	(749)
Amortization of loss	367	929	536
Net periodic pension expense	\$ 662	\$ 936	\$ 451

In 2017, the Company expects amortization of net gains and losses of \$732.

	<b>2016</b>	<b>2015</b>
Loss recognized as a component of accumulated other comprehensive loss:	\$ 4,881	\$ 5,249

The assumptions used to account for the Plan as of December 31, 2016 and 2015 are as follows:

	<b>2016</b>	<b>2015</b>
Discount rate for benefit obligation	4.10%	4.30%
Discount rate for pension expense	4.30%	3.97%
Expected long-term rate of return on assets	6.53%	6.53%
Rate of compensation increase	0.00%	0.00%

The discount rate for December 31, 2016 and 2015 was calculated using a proprietary yield curve based on above median AA rated corporate bonds. 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.

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:

	<b>Minimum</b>	<b>Maximum</b>
<b><u>Asset Category</u></b>		
Equity securities	50%	80%
Fixed income	20%	50%
Cash equivalents	0%	5%

The Plan's asset allocations at December 31, 2016 and 2015 by asset category are as follows:

	<b>2016</b>	<b>2015</b>
<b><u>Asset Category</u></b>		
Equity securities*	66%	64%
Debt securities*	32%	34%
Other/Cash	2%	2%

\* May include mutual funds comprised of both stocks and bonds.

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 years and beyond) Plan asset growth objective is to achieve a rate of return that exceeds the actuarial interest assumption after fees and expenses.

Because of the Company's long-term investment objectives, the Plan administrator is directed to resist being reactive to short-term capital market developments and to maintain an asset mix that is continuously rebalanced to adhere to the plan investment mix guidelines. The Plan's investment goal is to protect the assets' long-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.



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The following table presents major categories of plan assets as of December 31, 2016, and inputs and valuation techniques used to measure the fair value of plan assets regarding the ACS Retirement Plan:

<u>Asset Category</u>	<b>Fair Value Measurement at Reporting Date Using</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
Money market/cash	\$ 211	\$ 211	\$	\$
Equity securities (Investment Funds)*				
International growth	1,594	1,594		
U.S. small cap	1,607	1,607		
U.S. medium cap	1,489	1,489		
U.S. large cap	2,832	2,832		
Debt securities (Investment Funds)*				
Certificate of deposits	1,847	1,847		
Fixed income	1,813	1,813		
	\$ 11,393	\$ 11,393	\$	\$

\* May include mutual funds comprised of both stocks and bonds.

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

2017	\$ 1,084
2018	\$ 1,097
2019	\$ 1,085
2020	\$ 1,089
2021	\$ 1,093
2022-2026	\$ 5,264

***Post-retirement Health Benefit Plan***

The Company has a separate executive post-retirement health benefit plan. On December 31, 2016, the plan was underfunded by \$192 with plan assets of \$85. The net periodic post-retirement cost for 2016 and 2015 was \$12 and \$9, respectively.

**15. EARNINGS PER SHARE**

Earnings per share is based on the weighted average number of shares of common stock and dilutive potential common share equivalents outstanding. Basic earnings per share includes no dilution and is computed by dividing net income or loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution of securities that could share in the earnings of the Company. Excluded from the calculation of diluted earnings per share for the year ended December 31, 2016 were RSUs and PSUs totaling 4 which were out-of-the-money and therefore anti-dilutive. Due to the Company's reported net loss for the year ended December 31, 2014, 2,345 potential common share equivalents outstanding, which consisted of restricted stock and deferred shares granted to directors, were anti-dilutive. Also excluded from the calculations were shares related to the Company's 6.25% Notes which were anti-dilutive for the year ended December 31, 2014.

Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****15. EARNINGS PER SHARE (Continued)**

While it is the Company's intent to settle the principal portion of its 6.25% Notes in cash, the Company used the if converted method in calculating the diluted earnings per share effect of the assumed conversion of the contingently convertible debt through December 31, 2014. Under the if converted method, the after tax effect of interest expense related to the convertible securities is added back to net income and the convertible debt is assumed to have been converted into common stock at the earlier of the debt issuance date or the beginning of the period.

Effective in 2015, the Company discontinued use of the if converted method in calculating diluted earnings per share in connection with the contingently convertible debt. The Company's 6.25% Notes are convertible by the holder beginning February 1, 2018 at an initial conversion rate of 97.2668 shares of common stock per one thousand dollars principal amount of the 6.25% Notes. This is equivalent to an initial conversion price of approximately \$10.28 per share of common stock. Given that the Company's current share price is well below \$10.28, the Company does not anticipate that there will be a conversion of the 6.25% Notes into equity. Effective in the first quarter of 2015, the Company determined that it has the intent and ability to settle the principal and interest payments on its 6.25% Notes in cash over time. This determination was based on (i) the Company's improved liquidity position subsequent to the Wireless Sale, including its performance against the financial ratios defined under the terms of its then in effect 2010 Senior Credit Facility, reduced levels of debt and increased availability under its revolving credit facility; (ii) its intention to refinance its term loan facility to provide additional borrowing flexibility; and (iii) its expectations of future operating performance. In the third quarter of 2015, the Company successfully completed the aforementioned refinancing transactions which resulted in a reduction in total borrowings and provided for maturities on the Company's term loan facilities in 2018 compared with 2016 under the 2010 Senior Credit Facility. See Note 11

*Long-Term Obligations.* Accordingly, 9,220 and 10,809 shares related to the 6.25% Notes were excluded from the calculation of diluted earnings per share for the years ended December 31, 2016 and 2015, respectively. Pursuant to the 2017 Senior Credit Facility, the Company intends to commence a tender offer for its outstanding 6.25% Notes. See Note 22 *Subsequent Events*.

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2016, 2015 and 2014:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income (loss) attributable to Alaska Communications	\$ 2,386	\$ 12,954	\$ (2,780)
Tax-effected interest expense attributable to convertible notes	NA	NA	
	\$ 2,386	\$ 12,954	\$ (2,780)

Net income (loss) attributable to Alaska Communications  
assuming dilution

Weighted average common shares outstanding:

Basic shares	51,169	50,247	49,334
Effect of stock-based compensation	1,019	1,121	
Effect of 6.25% convertible notes	NA	NA	
Diluted shares	52,188	51,368	49,334

Income (loss) per share attributable to Alaska Communications:

Basic	\$ 0.05	\$ 0.26	\$ (0.06)
Diluted	\$ 0.05	\$ 0.25	\$ (0.06)

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Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****16. INCOME TAXES**

Consolidated income (loss) before income tax was as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Income (loss) before income tax	\$ 3,752	\$ 23,085	\$ (4,567)

The income tax provision for the years ended December 31, 2016, 2015 and 2014 was comprised of the following:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Current:</b>			
Federal income tax	\$ (276)	\$ 4,320	\$ 217
State income tax	6	693	43
Total current (benefit) expense	(270)	5,013	260
<b>Deferred:</b>			
Federal, excluding operating loss carry forwards	1,680	69,774	(1,620)
State, excluding operating loss carry forwards	228	19,725	(427)
Change in valuation allowance	(139)		
Tax benefit of operating loss carry forwards:			
Federal		(66,285)	
State		(18,027)	
Total deferred expense (benefit)	1,769	5,187	(2,047)
Total income tax expense (benefit)	\$ 1,499	\$ 10,200	\$ (1,787)

The following table provides a reconciliation of income tax expense (benefit) at the Federal statutory rate of 35% to the recorded income tax expense (benefit) for the years ended December 31, 2016, 2015 and 2014, respectively:

<b>2016</b>	<b>2015</b>	<b>2014</b>
-------------	-------------	-------------

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Computed federal income taxes at the statutory rate	\$ 1,313	\$ 8,080	\$ (1,598)
Expense (benefit) in tax resulting from:			
State income taxes (net of Federal benefit)	229	1,408	(278)
Other	(209)	263	58
Stock-based compensation	27	449	31
Change in valuation allowance	139		
<b>Total income tax expense (benefit)</b>	<b>\$ 1,499</b>	<b>\$ 10,200</b>	<b>\$ (1,787)</b>

Income tax expense (benefit) was charged to the statement of comprehensive income (loss) and statement of stockholders' equity (deficit) as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Statement of comprehensive income (loss):			
Income (loss) before income tax	\$ 1,499	\$ 10,200	\$ (1,787)
Other comprehensive income (loss)	\$ 128	\$ 1,434	\$ 320
Statement of stockholders' equity (deficit):			
Additional paid-in capital:			
Excess tax expense (benefit) from share-based payments	\$ 47	\$ (733)	\$

The Company accounts for income taxes under the asset-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. Valuation allowances are provided when it is more likely than not that the benefits of existing deferred tax assets will not be realized in a future period. As of December 31, 2016 and 2015, the Company had valuation allowances on certain state net operating loss carryforwards of \$139 and zero, respectively. As of December 31, 2016 and 2015, the change in the valuation

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****16. INCOME TAXES (Continued)**

allowance was \$139 and zero, respectively. At December 31, 2016, it is more likely than not that the results of future operations will generate sufficient taxable income to realize existing deferred tax assets, other than the state net operating loss carryforwards noted above. Therefore, no additional valuation allowance is necessary.

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2016 and 2015, respectively, are as follows:

	<b>2016</b>	<b>2015</b>
Deferred tax assets:		
Net operating loss carry forwards	\$ 26,429	\$ 16,863
Deferred GCI capacity revenue	15,340	22,654
Reserves and accruals	12,499	6,522
Intangibles and goodwill	1,620	1,765
Fair value on interest rate swaps	25	
Pension liability	1,804	2,010
Allowance for doubtful accounts	458	696
Alternative minimum tax carry forward	9,380	9,668
Other	257	277
<b>Total deferred tax assets</b>	<b>67,812</b>	<b>60,455</b>
Valuation allowance	(139)	
<b>Deferred tax assets after valuation allowance</b>	<b>67,673</b>	<b>60,455</b>
Deferred tax liabilities:		
Debt issuance costs	(933)	(1,907)
Property, plant and equipment	(52,022)	(41,886)
Fair value on interest rate swaps		(2)
<b>Total deferred tax liabilities</b>	<b>(52,955)</b>	<b>(43,795)</b>
<b>Net deferred tax asset</b>	<b>\$ 14,718</b>	<b>\$ 16,660</b>

As of December 31, 2016, the Company has available Federal and state alternative minimum tax credits of \$8,672 and \$1,089, respectively. As of December 31, 2016, the Company has available Federal and state net operating loss carry forwards of \$67,514 and \$46,044, respectively, which have various expiration dates beginning in 2031 through 2036.

The Company files consolidated income tax returns for Federal and state purposes in addition to separate tax returns of certain subsidiaries in multiple state jurisdictions. As of December 31, 2016, the Company is not under examination by any income tax jurisdiction. The Company is no longer subject to examination in the United States for years prior to 2013.

The Company accounts for income tax uncertainties using a threshold of *more-likely-than-not* in accordance with the provisions of ASC Topic 740, *Income Taxes* ( *ASC 740* ). As of December 31, 2016, the Company has reviewed all of its tax filings and positions taken on its returns and has not identified any material current or future effect on its consolidated results of operations, cash flows or financial position. As such, the Company has not recorded any tax, penalties or interest on tax uncertainties. It is Company policy to record any interest on tax uncertainties as a component of income tax expense.

## **17. STOCK INCENTIVE PLANS**

Under the Company's stock incentive plan, Alaska Communications, through the Compensation and Personnel Committee of its Board of Directors, may grant stock options, restricted stock, stock appreciation rights and other awards to officers, employees, consultants, and non-employee directors. Upon the effective date of the Alaska Communications Systems Group, Inc. 2011 Incentive Award Plan, as amended and restated on June 30, 2014, ( *2011 Incentive Award Plan* ), the Alaska Communications Systems Group, Inc. 1999 Stock Incentive Plan and



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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**17. STOCK INCENTIVE PLANS (Continued)**

the ACS Group, Inc. 1999 Non-Employee Director Stock Compensation Plan, (together the Prior Plans ) were retired. All future awards will be granted from the 2011 Incentive Award Plan. The Alaska Communications Systems Group, Inc. 2012 ESPP was approved by the Company's shareholders in June 2012 and the ACS 1999 Employee Stock Purchase Plan ( 1999 ESPP ) was retired on June 30, 2012. References to stock incentive plans include, as applicable, the 2011 Incentive Award Plan, the 2012 ESPP, the 1999 ESPP and the Prior Plans. An aggregate of 19,210 shares of the Company's common stock have been authorized for issuance under its stock incentive plans. Stock-based compensation expense is charged to Selling, general and administrative expense in the Consolidated Statements of Comprehensive Income (Loss).

***2011 Incentive Award Plan***

On June 10, 2011, Alaska Communications shareholders approved the 2011 Incentive Award Plan, which was amended and restated on June 30, 2014 and which terminates in 2021. Following termination, all shares granted under this plan, prior to termination, will continue to vest under the terms of the grant when awarded. All remaining unencumbered shares of common stock previously allocated to the Prior Plans were transferred to the 2011 Incentive Award Plan. In addition, to the extent that any outstanding awards under the Prior Plans are forfeited or expire or such awards are settled in cash, such shares will again be available for future grants under the 2011 Incentive Award Plan. The Company grants Restricted Stock Units and Performance Stock Units as the primary equity based incentive for executive and certain non union-represented employees.

***Restricted Stock Units, Long-term Incentive Awards and Non-Employee Director Stock Compensation***

RSUs issued prior to December 31, 2010 vest ratably over three, four or five years, RSUs issued in 2011 vest ratably over three years, and RSUs granted in 2012 vest in one year or ratably over three years. Long-term incentive awards ( LTIP ) were granted to executive management annually through 2010. The LTIP awards cliff vest in five years with accelerated vesting in three years if cumulative three-year profitability criteria are met. Since January 2008, the Company has maintained a policy which requires that non-employee directors receive a portion of their annual retainer in the form of Alaska Communications stock. Non-employee director stock compensation vests when granted. The directors make an annual election on whether to have the stock issued or to have it deferred.

The following table summarizes the RSU, LTIP and non-employee director stock compensation activity for the year ended December 31, 2016:

	<b>Number of Shares</b>	<b>Weighted Average Grant-Date Fair Value</b>
Nonvested at December 31, 2015	1,186	\$ 1.83
Granted	925	\$ 1.74
Vested	(697)	\$ 1.81
Canceled or expired		\$
Nonvested at December 31, 2016	1,414	\$ 1.79

*Performance Based Units*

PSUs vest ratably over three years beginning at the grant date, subject to certain Company financial targets being met and approval of the Compensation and Personnel Committee of the Board of Directors.

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Table of Contents**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****17. STOCK INCENTIVE PLANS (Continued)**

The following table summarizes PSU activity for the year ended December 31, 2016:

	<b>Number of Shares</b>	<b>Weighted Average Grant-Date Fair Value</b>
Nonvested at December 31, 2015	984	\$ 1.78
Granted	803	\$ 1.74
Vested	(432)	\$ 1.76
Canceled or expired	(21)	\$ 1.84
Nonvested at December 31, 2016	1,334	\$ 1.77

*Valuation Assumptions*

Assumptions used for valuation of equity instruments awarded during the years ended December 31, 2016, 2015 and 2014 are as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Restricted stock:			
Risk free rate	0%	0%	0.0% - 0.23%
Quarterly dividend	\$	\$	\$
Expected, per annum, forfeiture rate	9%	9%	9%

*Selected Information on Equity Instruments and Share-Based Compensation*

Selected information on equity instruments and share-based compensation under the plan for the years ended December 31, 2016, 2015 and 2014 is as follows:

	<b>Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Total compensation cost for share-based payments	\$ 2,830	\$ 2,008	\$ 2,511
Weighted average grant-date fair value of equity instruments granted	\$ 1.74	\$ 1.82	\$ 1.87
Total fair value of shares vested during the period	\$ 2,029	\$ 2,615	\$ 2,935
Unamortized share-based payments	\$ 1,562	\$ 1,421	\$ 1,392
Weighted average period in years to be recognized as expense	1.36	1.39	1.45

Share-based compensation expense is classified as Selling, general and administrative expense in the Company's Consolidated Statements of Comprehensive Income (Loss).

The Company purchases, from shares authorized under the 2011 Incentive Award Plan, sufficient vested shares to cover minimum employee payroll tax withholding requirements upon the vesting of restricted stock. The Company expects to repurchase approximately 333 shares in 2017. This amount is based upon an estimation of the number of shares of restricted stock awards expected to vest during 2017.

#### ***Alaska Communications Systems Group, Inc. 2012 Employee Stock Purchase Plan***

The Alaska Communications Systems Group, Inc. 2012 Employee Stock Purchase Plan was approved by the Company's shareholders in June 2012 and replaced the Alaska Communications Systems Group, Inc. 1999 Employee Stock Purchase Plan, as amended. The 2012 ESPP will terminate upon the earlier of (i) the last exercise date prior to the tenth anniversary of the adoption date, unless sooner terminated in accordance with the 2012 ESPP; or (ii) the date on which all purchase rights are exercised in connection with a change in

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**17. STOCK INCENTIVE PLANS (Continued)**

ownership of the Company. The terms of the 2012 ESPP are similar to those of the 1999 ESPP. Under the terms of the 2012 ESPP, all Alaska Communications employees and all employees of designated subsidiaries generally will be eligible to participate in the 2012 ESPP, other than employees whose customary employment is not more than 20 hours per week and five months in a calendar year, or who are ineligible to participate due to restrictions under the Internal Revenue Code. A participant in the 2012 ESPP will be granted a purchase right to acquire shares of common stock at six-month intervals on an ongoing basis, subject to the continuing availability of shares under the 2012 ESPP. Each participant may authorize periodic payroll deductions in any multiple of 1% (up to a maximum of 15%) of eligible compensation to be applied to the acquisition of common stock at semiannual intervals. The 2012 ESPP imposes certain limitations upon a participant's rights to acquire common stock, including (i) purchase rights granted to a participant may not permit the individual to purchase more than \$25 worth of common stock for each calendar year in which those purchase rights are outstanding at any time; (ii) purchase rights may not be granted to any individual if the individual would, immediately after the grant, own or hold outstanding options or other rights to purchase, stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or any of its subsidiaries; and (iii) no participant may purchase more than 10 shares of common stock during any six month offering period. The offering dates are January 1 and July 1 and the purchase dates are June 30 and December 31. The initial purchase date under the 2012 ESPP was December 31, 2012. Shares are purchased on the open market or issued from authorized but unissued shares on behalf of the participant on the purchase date. No participant will have any shareholder rights with respect to the shares covered by their purchase rights until the shares are actually purchased on the participant's behalf. No adjustments will be made for dividends, distributions or other rights for which the record date is prior to the date of the actual purchase.

The Company reserved 1,500 shares of its common stock for issuance under the 2012 ESPP, which were also available for issuance for the January 1, 2012 through June 30, 2012 offering period under the 1999 ESPP. Any shares issued to employees in respect to the January 1, 2012 through June 30, 2012 offering period under the 1999 ESPP reduced (on a one for one basis) the aggregate number of shares available for issuance thereafter under the 2012 ESPP. The fair value of each purchase right under the 2012 ESPP is charged to compensation expense over the offering period to which the right pertains, and is reflected in total compensation cost for share-based payments in the above table. Shares purchased by employees and the associated compensation expense under the 2012 ESPP, which is reflected in the preceding table, were not material in the years ended December 31, 2016, 2015 and 2014.

**18. SUPPLEMENTAL CASH FLOW INFORMATION**

The following table presents supplemental non-cash transaction information for the years ended December 31, 2016, 2015 and 2014:

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**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****18. SUPPLEMENTAL CASH FLOW INFORMATION (Continued)**

	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Supplemental Non-cash Transactions:</b>			
Capital expenditures incurred but not paid at December 31	\$ 3,508	\$ 11,600	\$ 6,678
Property acquired under capital leases	\$	\$ 20	\$ 1,877
Additions to ARO asset	\$ 159	\$ 254	\$ 369
Accrued acquisition purchase price	\$	\$	\$ 291
Non-cash acquisition, net of cash received	\$	\$	\$ 956
Assets contributed to joint venture by noncontrolling interest	\$	\$ 922	\$
Note receivable on sale of asset	\$	\$ 2,650	\$
<b>Nonmonetary Exchanges:</b>			
Property, plant and equipment	\$	\$ 710	\$
Deferred revenue	\$	\$ (2,310)	\$
Prepaid expenses	\$	\$ 1,600	\$
IRUs received	\$	\$ 2,765	\$
IRUs relinquished	\$	\$ (2,765)	\$

**19. BUSINESS SEGMENTS**

The Company operates its business under a single reportable segment. The Company's chief operating decision maker assesses the financial performance of the business as follows: (i) revenues are managed on the basis of specific customers and customer groups; (ii) costs are managed and assessed by function and generally support the organization across all customer groups or revenue streams; (iii) profitability is assessed at the consolidated level; and (iv) investment decisions and the assessment of existing assets are based on the support they provide to all revenue streams.

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****19. BUSINESS SEGMENTS (Continued)**

The following table presents service and product revenues from external customers for the years ended December 31, 2016, 2015 and 2014:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Wireline Revenue</b>			
Business and Wholesale Revenue			
Business broadband	\$ 59,218	\$ 51,058	\$ 44,461
Business voice and other	27,903	28,909	28,827
Managed IT services	4,173	3,316	3,492
Equipment sales and installations	6,441	6,274	5,195
Wholesale broadband	31,581	28,126	23,216
Wholesale voice and other	7,539	8,764	9,925
<b>Total Business and Wholesale Revenue</b>	<b>136,855</b>	<b>126,447</b>	<b>115,116</b>
<b>Consumer Revenue</b>			
Broadband	24,981	25,621	25,689
Voice and other	12,763	14,408	15,773
<b>Total Consumer Revenue</b>	<b>37,744</b>	<b>40,029</b>	<b>41,462</b>
<b>Total Business, Wholesale, and Consumer Revenue</b>	<b>174,599</b>	<b>166,476</b>	<b>156,578</b>
<b>Regulatory Revenue</b>			
Access	32,412	33,644	35,323
High cost support	19,855	19,682	23,192
<b>Total Regulatory Revenue</b>	<b>52,267</b>	<b>53,326</b>	<b>58,515</b>
<b>Total Wireline Revenue</b>	<b>226,866</b>	<b>219,802</b>	<b>215,093</b>
<b>Wireless &amp; AWN Related Revenue</b>			
Service revenue, equipment sales and other		6,300	77,054



Transition services	4,769	
CETC	1,654	19,565
Amortization of deferred AWN capacity revenue	292	3,151
<b>Total Wireless &amp; AWN Related Revenue</b>	<b>13,015</b>	<b>99,770</b>
 Total Operating Revenue	 \$ 226,866	 \$ 232,817      \$ 314,863

The Company's revenues are derived entirely from external customers in the United States and its long-lived assets are held entirely in the United States.

## 20. COMMITMENTS AND CONTINGENCIES

The Company enters into purchase commitments with vendors in the ordinary course of business, including minimum purchase agreements. The Company also has long-term purchase contracts with vendors to support the on-going needs of its business. These purchase commitments and contracts have varying terms and in certain cases may require the Company to buy goods and services in the future at predetermined volumes and at fixed prices.

The Company is involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of business and has recorded a liability for estimated litigation costs of \$1,271 at December 31, 2016 against certain current claims and legal actions. The Company also faces contingencies that are reasonably possible to occur, however, they cannot currently be estimated. The Company believes that the disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, comprehensive income or cash flows. It is the Company's policy to expense costs associated with loss contingencies, including any related legal fees, as they are incurred.

**Table of Contents****ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.****Notes to Consolidated Financial Statements, Continued****Years Ended December 31, 2016, 2015 and 2014****(In Thousands, Except Per Share Amounts)****21. SELECTED QUARTERLY FINANCIAL INFORMATION**

	Quarterly Financial Data				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
<b>2016</b>					
Operating revenues	\$ 56,328	\$ 56,262	\$ 56,483	\$ 57,793	\$ 226,866
Gross profit (before charge for depreciation and amortization)	\$ 30,200	\$ 30,719	\$ 31,090	\$ 32,720	\$ 124,729
Operating income	\$ 4,316	\$ 4,365	\$ 4,100	\$ 6,728	\$ 19,509
Net income	\$ 53	\$ 283	\$ 320	\$ 1,597	\$ 2,253
Net income attributable Alaska Communications	\$ 86	\$ 317	\$ 354	\$ 1,629	\$ 2,386
Net income per share attributable to Alaska Communications:					
Basic	\$	\$ 0.01	\$ 0.01	\$ 0.03	\$ 0.05
Diluted	\$	\$ 0.01	\$ 0.01	\$ 0.03	\$ 0.05
<b>2015</b>					
Operating revenues	\$ 65,786	\$ 55,665	\$ 54,735	\$ 56,631	\$ 232,817
Gross profit (before charge for depreciation and amortization)	\$ 34,520	\$ 25,587	\$ 30,062	\$ 30,525	\$ 120,694
Operating income (loss)	\$ 39,313	\$ (4,375)	\$ 8,178	\$ 4,630	\$ 47,746
Net income (loss)	\$ 16,217	\$ (4,860)	\$ 1,202	\$ 326	\$ 12,885
Net income (loss) attributable Alaska Communications	\$ 16,217	\$ (4,841)	\$ 1,239	\$ 339	\$ 12,954
Net income (loss) per share attributable to Alaska Communications:					
Basic	\$ 0.32	\$ (0.10)	\$ 0.02	\$ 0.01	\$ 0.26
Diluted	\$ 0.32	\$ (0.10)	\$ 0.02	\$ 0.01	\$ 0.25

Operating income (loss), net income (loss), net income (loss) attributable to Alaska Communications and per share amounts in 2015 reflect the gain before income taxes on the Wireless Sale of \$39,719, \$1,421, \$7,092 and \$48,232 in the first quarter, second quarter, third quarter and total year, respectively.

**22. SUBSEQUENT EVENTS*****New Senior Credit Facility***

On March 13, 2017, the Company entered into a new senior credit facility consisting of a Term A-1 Facility of \$120,000, a Term A-2 Facility of \$60,000 and a Revolving Facility of \$15,000 (together the 2017 Senior Credit Facility or Agreement ). Upon the satisfaction of certain conditions, on or before March 28, 2017, the Company will utilize proceeds from the 2017 Senior Credit Facility and cash on hand to repay in full its 2015 Senior Credit Facilities, including accrued interest and fees, of approximately \$87,800, fund the tender of its 6.25% Notes in the amount of \$94,000 as described below and fund fees and expenses associated with this transaction. Principal payments under the 2015 Senior Credit Facilities are due in 2017 and 2018. The 6.25% Notes are due in 2018.

The Term A-1 Facility and draws under the Revolving Facility bear interest at LIBOR plus 5.0% per annum, with a LIBOR minimum of 1.0%, or 4.0% per annum plus an Alternate Base Rate as defined in the Agreement. The Term A-2 Facility bears interest at LIBOR plus 7.0% per annum, with a LIBOR minimum of 1.0%, or 6.0% per annum plus an Alternate Base Rate as defined in the Agreement.

Principal payments on the Term A-1 Facility are \$1,500 per quarter beginning in the fourth quarter of 2017 through the first quarter of 2020, \$2,250 per quarter beginning in the second quarter of 2020 through the first

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**ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.**

**Notes to Consolidated Financial Statements, Continued**

**Years Ended December 31, 2016, 2015 and 2014**

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

**22. SUBSEQUENT EVENTS (Continued)**

quarter of 2021, and \$4,000 per quarter beginning in the second quarter of 2021 through the fourth quarter of 2021. The remaining outstanding principal balance is due on March 13, 2022. Principal payments on the Term A-2 Facility are \$150 per quarter beginning in the fourth quarter of 2017 through the first quarter of 2021 and \$600 per quarter beginning in the second quarter of 2021 through the fourth quarter of 2022. The remaining outstanding principal balance is due on March 13, 2023.

Upon funding, the obligations under the 2017 Senior Credit Facility will be secured by perfected first lien priority security interests in substantially all of the Company's and its direct and indirect subsidiary's tangible and intangible assets, subject to certain agreed exceptions.

The 2017 Senior Credit Facility contains customary representations, warranties and covenants, including covenants limiting the incurrence of debt, the payment of dividends and repurchase of the Company's common stock.

The 2017 Senior Credit Facility provides for events of default customary for credit facilities of this type, including non-payment defaults on other debt, misrepresentation, breach of covenants, representations and warranties, change of control, and insolvency and bankruptcy.

***Tender Offer on 6.25% Notes***

Pursuant to the 2017 Senior Credit Facility, the Company intends to commence a tender offer for its outstanding 6.25% Convertible Notes due 2018. The offer will commence upon the filing of Schedule TO with the Securities and Exchange Commission. The outstanding principal balance of the 6.25% Notes was \$94,000 at December 31, 2016.

***Share Repurchase Program***

On March 13, 2017, the Company announced that its Board of Directors authorized a stock repurchase program for the Company to repurchase up to \$10,000 of its Common Stock through December 2019. Shares repurchased under the program will be accounted for as treasury stock.

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**The Alaska Wireless Network, LLC**

**(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)**

Financial Statements

December 31, 2014 and 2013

(With Report of Independent Registered Public Accounting Firm)

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING  
FIRM**

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Board of Directors and Members

The Alaska Wireless Network, LLC

We have audited the accompanying balance sheets of The Alaska Wireless Network, LLC (a Delaware Limited Liability Company) (the Company) as of December 31, 2014 and 2013, and the related statements of income, changes in members' equity, and cash flows for the year ended December 31, 2014 and for the period from July 23, 2013 through December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Alaska Wireless Network, LLC as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the year ended December 31, 2014 and for the period from July 23, 2013 through December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

Anchorage, Alaska

March 3, 2015

**Grant Thornton LLP**

U.S. member firm of Grant Thornton International Ltd

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## BALANCE SHEETS

December 31, 2014 and 2013

(Amounts in thousands)

	2014	2013
<b>ASSETS</b>		
Current assets:		
Cash	\$ 1,371	3,527
Receivables from related parties	124,281	100,549
Receivables from non-related parties, net	12,235	14,225
Total receivables	136,516	114,774
Prepaid expenses	1,126	1,309
Other current assets	224	71
Total current assets	139,237	119,681
Property and equipment in service, net of depreciation	188,752	191,805
Construction in progress	44,614	32,959
Net property and equipment	233,366	224,764
Goodwill	164,312	155,445
Wireless licenses	86,347	91,400
Rights to use capacity, net of amortization of \$3,470 and \$1,221 at December 31, 2014 and 2013, respectively	44,812	54,185
Future capacity	16,343	15,313
Software licenses, net of amortization of \$11,769 and \$8,474 at December 31, 2014 and 2013, respectively	8,670	7,877
Other assets	758	929
Total other assets	321,242	325,149
Total assets	\$ 693,845	669,594

(Continued)

The accompanying notes are an integral part of these financial statements.





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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## BALANCE SHEETS

December 31, 2014 and 2013

(Amounts in thousands)

(Continued)

	2014	2013
<b>LIABILITIES AND MEMBERS' EQUITY</b>		
Current liabilities:		
Accounts payable to related parties	\$ 67,970	62,155
Accounts payable to non-related parties	20,745	7,862
Deferred revenues	2,314	1,996
Accrued liabilities	218	229
Total current liabilities	91,247	72,242
Line of credit from GCI Holdings, Inc.	2,116	3,874
Asset retirement obligations	15,674	14,792
Other liabilities	3,715	1,904
Total liabilities	112,752	92,812
Commitments and contingencies		
Members' equity	581,093	576,782
Total liabilities and members' equity	\$ 693,845	669,594

The accompanying notes are an integral part of these financial statements.

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## INCOME STATEMENTS

For the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013

(Amounts in thousands)

	2014	2013
Revenues:		
Related parties	\$ 139,069	71,732
Non-related parties	113,795	47,186
Total revenues	252,864	118,918
Cost of goods sold (exclusive of depreciation and amortization shown separately below):		
Related parties	8,103	3,867
Non-related parties	65,518	28,850
Total cost of goods sold	73,621	32,717
Selling, general and administrative expenses:		
Related parties	17,224	8,100
Non-related parties	4,410	2,380
Total selling, general and administrative expenses	21,634	10,480
Depreciation and amortization expense	43,837	19,178
Operating income	113,772	56,543
Interest expense to related party (including amortization of deferred loan fees)	368	201
Net income	\$ 113,404	56,342

The accompanying notes are an integral part of these financial statements.

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## STATEMENTS OF MEMBERS' EQUITY

For the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013

(Amounts in thousands)

	Members' Accounts	Capital	Allocable Earnings	Total
Balances at July 23, 2013	\$			
Net income			56,342	56,342
Contributions from members		574,418		574,418
Distributions to members			(53,978)	(53,978)
Allocation to members of income in excess of distributions		2,364	(2,364)	
Balances at December 31, 2013	\$	576,782		576,782
Net income			113,404	113,404
Distributions to members			(106,962)	(106,962)
Allocation to members of income in excess of distributions		6,442	(6,442)	
Final valuation contribution adjustment		(2,131)		(2,131)
Balances at December 31, 2014	\$	581,093		581,093

The accompanying notes are an integral part of these financial statements.

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## STATEMENTS OF CASH FLOWS

For the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013

(Amounts in thousands)

	2014	2013
Cash flows from operating activities:		
Net income	\$ 113,404	56,342
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	43,837	19,178
Other noncash income and expense items	1,299	425
Changes in operating assets and liabilities, net of amounts acquired:		
Receivables from non-related parties	1,492	(14,225)
Receivables from related parties	(39,218)	(57,335)
Prepaid expenses	183	(1,309)
Other current assets	(142)	(71)
Other assets	25	95
Accounts payable to non-related parties	(3,400)	5,989
Accounts payable to related parties	1,307	26,060
Accrued liabilities	(11)	229
Deferred revenues	100	1,996
Other liabilities	1,792	1,192
Net cash provided by operating activities	120,668	38,566
Cash flows from investing activities:		
Purchases of property and equipment	(30,198)	(18,533)
Purchases of software licenses and other assets	(4,207)	(1,662)
Grant proceeds	716	
Net cash used by investing activities	(33,689)	(20,195)
Cash flows from financing activities:		
Distribution to members	(86,968)	(17,844)
Payments to GCI Holdings, Inc. on line of credit	(14,167)	
Borrowings from GCI Holdings, Inc. on line of credit	12,000	3,000
Net cash used by financing activities	(89,135)	(14,844)
Net increase (decrease) in cash	(2,156)	3,527
Cash at beginning of period	3,527	
Cash at end of period	\$ 1,371	3,527

Supplemental cash flow data:		
Interest paid including capitalized interest	\$	534
Non-cash investing and financing activities:		
Net assets and liabilities transferred from members	\$	574,418
Asset retirement obligation additions to property and equipment	\$	168 116
Non-cash additions of property and equipment	\$	18,156 1,873
Distributions accrued, not yet paid	\$	40,642 36,134
Non-cash settlement of receivables from and payables to related parties	\$	15,486
Net assets adjusted due to AWN purchase price allocation true-up	\$	2,131
The accompanying notes are an integral part of these financial statements.		

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The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

NOTES TO FINANCIAL STATEMENTS

(1) **Business and Summary of Significant Accounting Principles**

In the following discussion, The Alaska Wireless Network, LLC ( AWN ) is referred to as we, us and our.

(a) **Description of the Business**

AWN was formed June 5, 2012 as a Delaware limited liability company, and as a majority owned subsidiary of GCI Wireless Holdings, LLC (a wholly owned subsidiary of General Communication, Inc. ( GCI )). As a result of the acquisition described below, GCI Wireless Holdings, LLC owns two-thirds and Alaska Communications Systems Group, Inc. ( ACS ) owns one-third of AWN.

We began operations on July 23, 2013, and offer the following services:

Wholesale wireless services to GCI and ACS

Wireless roaming for other wireless carriers

Backhaul for other wireless carriers

(b) **Acquisition**

Effective July 23, 2013, we closed the transactions under the Asset Purchase and Contribution Agreement ( Wireless Agreement ) entered into on June 4, 2012 by and among ACS, GCI, ACS Wireless, Inc., a wholly owned subsidiary of ACS, GCI Wireless Holdings, LLC, a wholly owned subsidiary of GCI, and AWN, pursuant to which the parties agreed to contribute the respective wireless network assets of GCI, ACS and their affiliates to AWN. AWN provides wholesale services to GCI and ACS. GCI and ACS use the AWN network to sell services to their respective retail customers. GCI and ACS continue to compete against each other and other wireless providers in the retail wireless market.

Under the terms of the Wireless Agreement, GCI contributed \$291.4 million in net assets consisting of its wireless network assets and certain rights to use capacity to AWN. Additionally, ACS contributed its wireless network assets and certain rights to use capacity to AWN. As consideration for the contributed business assets and liabilities, ACS received \$100.0 million in cash from GCI, a one-third ownership interest in AWN and entitlements to receive preferential cash distributions totaling \$190.0 million over the first four years of AWN's operations ( Preference Period ) contingent on the future cash flows of AWN. The preferential cash distribution is cumulative and may be paid beyond the Preference Period until the entire \$190.0 million is paid. We believe ACS's preferential cash distributions

are expected to be higher than that which they would receive from their one-third interest. GCI received a two-third ownership interest in AWN, as well as entitlements to receive all remaining cash distributions after ACS's preferential cash distributions during the Preference Period. The distributions to each member are subject to adjustment based on the number of ACS and GCI wireless subscribers, with the aggregate adjustment capped at \$21.8 million for each member over the Preference Period.

During the Preference Period net income is allocated to GCI and ACS based on their proportion of distributions up to the total distributions, as defined by AWN, during the period. Net income greater than the total distributions is allocated based on each member's proportional ownership interests. Following the Preference Period, GCI and ACS will receive distributions proportional to their ownership interests.

We accounted for the assets and liabilities contributed by ACS at estimated fair values as of July 23, 2013, using the acquisition method of accounting in accordance with Accounting Standards Codification (ASC) 850, *Business Combinations*. We used a combination of the discounted cash flows and market method to value the wireless licenses. We used the cost approach to value the acquired fixed assets and rights to use capacity assets. We used a discounted cash flow method to determine the fair value of ACS's member equity. The assets and liabilities contributed to us by GCI were measured at their carrying amount immediately prior to the contribution as GCI is maintaining control over the assets and liabilities. GCI's initial member equity is the carrying amount of GCI's contributed assets and liabilities.



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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## NOTES TO FINANCIAL STATEMENTS

The following table summarizes the final purchase price and the estimated fair value of ACS's assets acquired and liabilities assumed, effective July 23, 2013 (amounts in thousands):

	Previously Reported	Adjustments	Final Purchase Price Allocation
<b>Purchase price:</b>			
Cash consideration paid	\$ 100,000		100,000
Fair value of the one-third ownership interest of AWN	267,642	(2,131)	265,511
<b>Total purchase price</b>	<b>\$ 367,642</b>	<b>(2,131)</b>	<b>365,511</b>
<b>Assets acquired and liabilities assumed:</b>			
<b>Acquired assets</b>			
Current assets	\$ 16,952	11	16,963
Property and equipment, including construction in progress	82,473	138	82,611
Goodwill	140,081	8,867	148,948
Wireless licenses	65,433	(5,053)	60,380
Rights to use capacity	52,636	(7,298)	45,338
Future capacity	15,313	1,204	16,517
Other assets	765		765
Fair value of liabilities assumed	(6,011)		(6,011)
<b>Total fair value of assets acquired and liabilities assumed</b>	<b>\$ 367,642</b>	<b>(2,131)</b>	<b>365,511</b>

We modified the initial preliminary AWN purchase price allocation during 2014 as noted in the table above due to additional information received from ACS related to the allocation of ACS's network contributed to AWN that impacted the estimated fair value.

As of December 31, 2014, goodwill in the amount of \$164.3 million was recorded as a result of the acquisition including \$15.4 million in goodwill contributed by GCI. Goodwill is calculated as the excess of the consideration transferred over the net assets recognized and represents the estimated future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. The goodwill is primarily the result of synergies expected from the combination.

(c) Accounts Receivable from Non-related Parties and Allowance for Doubtful Receivables

Accounts receivable from non-related parties are recorded at the reported amount and do not bear interest. The allowance for doubtful receivables is our best estimate of the amount of probable credit losses in our existing accounts receivable from non-related parties. We base our estimates on the aging of our accounts receivable balances, financial health of customers, regional economic data, changes in our collections process and regulatory requirements. We review our allowance for doubtful receivables methodology at least annually.

Account balances are charged off against the allowance when we feel it is probable the receivable will not be recovered. We do not have any off-balance-sheet credit exposure related to our customers.

(d) Property and Equipment

Property and equipment is stated at cost. Construction costs of facilities are capitalized. Construction in progress represents transmission equipment and support equipment and systems not placed in service on December 31, 2014, that management intends to place in service during 2015.

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## NOTES TO FINANCIAL STATEMENTS

Depreciation is computed using the straight-line method in the following ranges:

Asset Category	Asset Lives
Telephony transmission equipment and distribution facilities	5-20 years
Support equipment and systems	3-20 years
Buildings	25 years

Repairs and maintenance are charged to expense as incurred. Expenditures for major renewals and betterments are capitalized. Accumulated depreciation is removed and gains or losses are recognized at the time of sales or other dispositions of property and equipment.

(e) Intangible Assets and Goodwill

Goodwill and wireless licenses are not amortized. Wireless licenses represent the right to utilize certain radio frequency spectrum to provide wireless communications services. Goodwill represents the excess of cost over fair value of net assets acquired in connection with a business acquisition.

Under the terms of the Wireless Agreement, we acquired from ACS rights to use its network capacity and the associated maintenance on this network capacity for 20 years. We are amortizing this intangible asset over 20 years using the straight-line method. We also acquired from ACS the rights to use additional network capacity which we may draw down in the future. The applicable portion of the future capacity asset will be reclassified to the rights to use capacity asset when the capacity is placed into service and amortized using the straight-line method over the remaining 20 year period.

Software licenses are recognized at cost and are being amortized over a 5 year period using the straight- line method.

(f) Impairment of Intangibles, Goodwill, and Long-lived Assets

Wireless license assets are treated as indefinite-lived intangible assets and are tested annually for impairment or more frequently if events and circumstances indicate that the asset might be impaired. We are allowed to assess qualitative factors ( Step Zero ) in our annual test over our indefinite-lived intangible assets other than goodwill.

Our goodwill is tested annually for impairment, and is tested for impairment more frequently if events and circumstances indicate that the assets might be impaired. In our annual test of goodwill, we are allowed to use Step Zero to determine whether it is more likely than not that goodwill is impaired.

We completed our annual review of wireless license assets and goodwill as of October 31, 2014 and 2013. No impairment charge was recorded for the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013.

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of an asset group to be held and used is measured by a comparison of the carrying amount of an asset group to estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

(g) Asset Retirement Obligations

We record the fair value of a liability for an asset retirement obligation in the period in which it is incurred on the Balance Sheet if the fair value of the liability can be reasonably estimated. When the liability is initially recorded, we capitalize a cost by increasing the carrying amount of the related long-lived asset. In periods subsequent to initial measurement, period-to-period changes in the liability for an asset retirement

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## NOTES TO FINANCIAL STATEMENTS

obligation resulting from revisions to either the timing or the amount of the original estimate of undiscounted cash flows are recognized. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, we either settle the obligation for its recorded amount or incur a gain or loss upon settlement.

The majority of our asset retirement obligations are the estimated cost to remove telephony transmission equipment and support equipment from leased property. Following is a reconciliation of the beginning and ending aggregate carrying amounts of our liability for asset retirement obligations (amounts in thousands):

Balance at July 23, 2013	\$ 14,408
Liability incurred	116
Accretion expense	270
Liability settled	(2)
Balance at December 31, 2013	14,792
Liability incurred	168
Accretion expense	733
Liability settled	(19)
Balance at December 31 2014	\$ 15,674

During year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013, we recorded additional capitalized costs of \$0.2 million and \$0.1 million, respectively in Property and Equipment in Service, Net of Depreciation.

(h) Revenue Recognition

All revenues are recognized when the earnings process is complete. If requested by GCI and ACS, we pay cash incentives to them when wireless handsets are sold to their respective retail customers. During the period July 23, 2013 to March 31, 2014, and in accordance with the Facilities and Network Use Agreement dated as of July 22, 2013 by and among AWN, ACS, GCI, ACS Wireless, Inc., and GCI Wireless Holdings, LLC ( "FNUA" ), GCI waived the right to request a cash incentive for wireless handsets sold to their retail customers. During the year ended December 31, 2014 and the period July 23, 2013 to December 2013, we recorded incentives of \$26.4 million and \$6.4 million, respectively, as an offset to Revenues - Related Parties.

Revenues generated from wireless service usage and plan fees are recognized when the services are provided. Plan fees and usage are self-reported to us by our carriers, GCI and ACS, and we recognize carrier plan fees as set out in

agreements with GCI and ACS.

As Eligible Telecommunications Carriers ( ETCs ), GCI and ACS receive high cost support from the Universal Service Fund ( USF ) to support the provision of wireless service in high cost areas, and this support is passed through to us. In 2011 the Federal Communications Commission ( FCC ) published a final rule to reform the methodology for, among others, distributing USF high cost support for voice and broadband services ( High Cost Order ).

#### Remote High Cost Support

Remote high cost support is based upon the 2011 support disbursed to Competitive Eligible Telecommunications Carriers ( CETCs ) ( Statewide Support Cap ) providing supported services in Remote Alaska, except AT&T. On January 1, 2012, the per-line rates paid in the Remote areas were frozen by the USF and cannot exceed \$250 per line per month on a study area basis. Line count growth that causes support to exceed the Statewide Support Cap triggers a pro rata support payment reduction to all subject Alaska CETCs until the support is reduced to the Statewide Support Cap amount.

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The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

NOTES TO FINANCIAL STATEMENTS

We accrue estimated program revenue based on current line counts and the frozen per-line rates, reduced as needed by our estimate of the impact of the Statewide Support Cap. When determining the estimated program revenue accrual, we also consider our assessment of the impact of current FCC regulations and of the potential outcome of FCC proceedings. Our estimated accrued revenue is subject to our judgment regarding the outcome of many variables and is subject to upward or downward adjustment in subsequent periods.

Additionally, the FCC determined that Remote support will continue to be based on line counts (subject to the Statewide Support Cap) until the last full month prior to the implementation of a successor funding mechanism. A further rulemaking to consider successor funding mechanisms is underway.

**Urban High Cost Support**

The High Cost Order mandated that Urban high cost support payments were frozen at the monthly average of the subject CETC's 2011 annual support and are not dependent upon line counts. A 20% annual phase down commenced July 1, 2012. The phase down has been capped at 60% and the subject CETCs will continue to receive annual support payments at the 60% level until a successor funding mechanism is implemented. A further rulemaking to consider successor funding mechanisms is underway and once a new funding mechanism is in place, the phase down should restart the annual 20% decrease until no support is paid.

We apply the proportional performance revenue recognition method to account for the impact of the declining payments while our level of service provided and associated costs remain constant. Included in the calculation are the scheduled Urban high cost support payments from October 2011 through July 2017. An equal amount of this result is recognized as Urban support revenue each period.

For both Remote and Urban high cost support revenue, our ability to collect our accrued USF support is contingent upon continuation of the USF program and upon GCI's and ACS's eligibility to participate in that program, which is subject to change by future regulatory, legislative or judicial actions. We adjust revenue and the account receivable in the period the FCC makes a program change, or we assess the likelihood that such a change has increased or decreased revenue. We do not recognize revenue related to a particular service area until GCI's and ACS's ETC status has been approved by the Regulatory Commission of Alaska.

We recorded high cost support revenue under the USF program of \$53.9 million and \$23.9 million for the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013, respectively. At December 31, 2014, we have \$42.1 million in high cost support accounts receivable.

(i) **Leases**

Scheduled operating lease rent increases are amortized over the expected lease term on a straight-line basis. Rent holidays are recognized on a straight-line basis over the operating lease term (including any rent holiday period).

Leasehold improvements are amortized over the shorter of their economic lives or the lease term. We may amortize a leasehold improvement over a term that includes assumption of a lease renewal if the renewal is reasonably assured. Leasehold improvements that are placed in service significantly after and are not contemplated at or near the beginning of the lease term are amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. Leasehold improvements made by us and funded by landlord incentives or allowances under an operating lease are recorded as deferred rent and amortized as reductions to lease expense over the lease term.

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The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

NOTES TO FINANCIAL STATEMENTS

(j) Comprehensive Income

Total comprehensive income was equal to net income during the year ended December 31, 2014 and the period from July 23, 2013 to December 31, 2013.

(k) Interest Expense

Material interest costs incurred during the construction period of capital projects are capitalized. Interest is capitalized in the period commencing with the first expenditure for a qualifying capital project and ending when the capital project is substantially complete and ready for its intended use. We capitalized interest costs of \$197,000 and \$49,000 during the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013, respectively.

(l) Income Taxes

We are organized as a limited liability corporation; therefore, all items of income, deduction, gain and loss pass through to our members. Accordingly, no provision for current or deferred income taxes has been made in the financial statements.

We account for uncertain tax positions under the provisions of ASC 740, *Income Taxes*, which requires us to recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. We had no unrecognized tax benefits, penalties, or interest as of December 31, 2014 and 2013. The tax years 2014 and 2013 remain open to examination by major taxing jurisdictions to which we are subject.

(m) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires us 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. Significant items subject to estimates and assumptions include the allowance for doubtful receivables, unbilled revenues, accrual of the USF high cost Remote area program support, depreciable and amortizable lives of assets, the carrying value of long-lived assets including goodwill and wireless licenses, purchase price allocations, deferred lease expense, asset retirement obligations, the accrual of cost of goods sold (exclusive of depreciation and amortization expense), depreciation and the accrual of contingencies and litigation. Actual results could differ from those estimates.

(n) Concentrations of Risk

Financial instruments that potentially subject us to concentrations of risk are primarily cash and accounts receivable. Excess cash is invested in high quality short-term liquid money instruments. At December 31, 2014, substantially all of our cash were invested in short-term liquid money instruments. At December 31, 2014 and 2013 cash balances were in excess of Federal Deposit Insurance Corporation insured limits.

We have the following major customers:

Customer	Percent of Total Revenues
Verizon	31%
GCI	33%
ACS	22%

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The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

NOTES TO FINANCIAL STATEMENTS

ACS and GCI are both members of AWN and are contractually required to purchase our wholesale wireless services for their customers. We provide roaming services for Verizon. Verizon has been developing their Alaskan Long Term Evolution network and the service provided over their network is limited to data only.

We also depend on a limited number of suppliers for roaming services outside Alaska. Our operating results could be adversely affected if these suppliers experience financial or credit difficulties, service interruptions, or other problems.

All services provided by us are in Alaska. Because of this geographic concentration, our growth and operations depend upon economic conditions in Alaska.

(o) Guarantees

Certain of our customers have guaranteed levels of service. If an interruption in service occurs we do not recognize revenue that will be refunded to the customer or not billed to the customer due to these service level agreements.

(p) Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers*, or ASU 2014-09. This new standard provides guidance for the recognition, measurement and disclosure of revenue resulting from contracts with customers and will supersede virtually all of the current revenue recognition guidance under GAAP. The standard is effective for the first interim period within annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are currently evaluating the impact of the provisions of this new standard on our financial position and results of operations.

(2) Net Property and Equipment in Service

Net property and equipment in service consists of the following at December 31, 2014 and 2013 (amounts in thousands):

	2014	2013
Land and buildings	\$ 544	521
Telephony transmission equipment and distribution facilities	290,083	255,991
Support equipment and systems	8,051	7,060

	298,678	263,572
Less accumulated depreciation	109,926	71,767
Net property and equipment in service	\$ 188,752	191,805

GCI and ACS contributed wireless facilities that may be redundant; therefore, we expect to complete an analysis of our wireless facilities to rationalize our combined network and have recorded a \$7.6 million reserve against our telephony transmission equipment and distribution facilities.

(3) Intangible Assets and Goodwill

As of October 31, 2014, wireless licenses and goodwill were tested for impairment and the fair values were greater than the carrying amounts; therefore, these intangible assets were determined not to be impaired at December 31, 2014. The remaining useful lives of our wireless licenses and goodwill were evaluated as of October 31, 2014, and events and circumstances continue to support an indefinite useful life.

There are no indicators of impairment of our rights to use capacity asset or software licenses as of December 31, 2014.

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## NOTES TO FINANCIAL STATEMENTS

Changes in intangible assets are as follows (amounts in thousands):

	Goodwill	Software Licenses	Rights to Use	Future Capacity
Balances at July 23, 2013	\$			
Additions from AWN acquisition	155,445	7,464	55,406	15,313
Asset additions		1,708		
Less amortization expense		(1,295)	(1,221)	
Balances at December 31, 2013	\$ 155,445	7,877	54,185	15,313
Purchase price adjustment	8,867		(7,298)	1,204
Capacity placed in service			174	(174)
Asset additions		4,207		
Less amortization expense		(3,414)	(2,249)	
Balances at December 31, 2014	\$ 164,312	8,670	44,812	16,343

Amortization expense for our rights to use capacity asset and software licenses for each of the five succeeding fiscal years is estimated to be (amounts in thousands):

Years Ending December 31,	
2015	\$ 5,576
2016	4,695
2017	3,507
2018	3,012
2019	2,668

**(4) Long-Term Debt**

We have a \$50.0 million line of credit from GCI Holdings, Inc., a wholly owned subsidiary of GCI, with an outstanding balance of \$2.1 million and \$3.9 million at December 31, 2014 and 2013, respectively. Outstanding obligations are due starting July 22, 2017 with the full balance due on July 22, 2021. The line of credit bears an interest rate of London Interbank Offered Rate plus the per annum interest rate margin being paid by GCI Holdings, Inc. As of December 31, 2014, the interest rate was 3.0%. Interest on the line of credit increases the outstanding obligation.

Maturities of the line of credit as of December 31, 2014 are as follows (amounts in thousands):

Years ending December 31,	
2015	\$
2016	
2017	265
2018	529
2019	529
2020 and thereafter	793
Total line of credit from GCI Holdings, Inc.	\$ 2,116

(5) Financial Instruments

Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. At December 31, 2014 and 2013, the fair values of cash, net receivables, accounts payable, deferred revenues and accrued liabilities approximate their carrying values due to the short-term nature of these financial instruments.

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## The Alaska Wireless Network, LLC

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## NOTES TO FINANCIAL STATEMENTS

Our line of credit of \$2.1 million outstanding with GCI Holdings, Inc. is estimated to approximate the carrying value because this instrument is subject to variable interest rates (Level 2).

**(6) Related Party Transactions**

We have significant transactions with our two members, GCI and ACS. We provide wholesale services to GCI and ACS who use our network to sell services to their respective retail customers, receive from GCI and ACS their high cost support from USF and provide cash incentives, when requested, to GCI and ACS when wireless handsets are sold to their respective retail customers. During the period July 23, 2013 to March 31, 2014, and in accordance with the FNUA, GCI waived the right to request a cash incentive for wireless handsets sold to their retail customers. We share with GCI certain capacity provided by third party vendors for which we reimburse GCI and receive services from GCI. The following table summarizes the amounts received from and paid to related parties for the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013 including amounts reimbursed by AWN to its members for services rendered by third parties, and the amounts receivable from and payable to related parties as of December 31, 2014 and 2013 (amounts in thousands):

	2014		2013	
	GCI	ACS	GCI	ACS
Paid to	\$ 52,517	53,427	\$ 16,195	19,795
Received in payments	28,099	48,387	8,817	21,167
Payable to	61,684	6,286	51,756	10,399
Receivable from	97,064	27,217	72,782	27,767

**(7) Member's Equity**

There is one class of membership interest in AWN. Under the terms of the First Amended and Restated Operating Agreement signed by ACS, GCI, ACS Wireless, and GCI Wireless Holdings, LLC ( Operating Agreement ), no member of AWN is liable for any of its debt, obligations or liabilities, except as provided for by law or in the Operating Agreement. A member cannot, unless otherwise provided for in the Operating Agreement, transfer all or any portion of its membership interest. No additional contributions beyond initial contributions are required of the members per the Operating Agreement.

During the Preference Period net income is allocated to GCI and ACS based on their proportion of distributions up to the total distributions, as defined by AWN, during the period. Net income greater than the total distributions is allocated based on each member's proportional ownership interests. Following the Preference Period, GCI and ACS will receive distributions proportional to their ownership interests.

(8) Commitments and Contingencies

Operating Leases

We primarily lease land for cell towers, space on cell towers, and urban rooftop space for cell sites. Many of our leases are for multiple years and contain renewal options. Rental costs under such arrangements amounted to \$7.4 million and \$2.9 million for the year ended December 31, 2014 and the period July 23, 2013 to December 31, 2013, respectively.

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## The Alaska Wireless Network, LLC

(A Majority Owned Subsidiary of GCI Wireless Holdings, LLC)

## NOTES TO FINANCIAL STATEMENTS

A summary of future minimum lease payments follows (amounts in thousands):

Years ending December 31:	Operating
2015	\$ 4,897
2016	4,214
2017	3,373
2018	2,664
2019	1,973
2020 and thereafter	21,038
<b>Total minimum lease payments</b>	<b>\$ 38,159</b>

The leases generally provide that we pay the taxes related to the leased assets. Several of our leases include renewal options, escalation clauses and immaterial amounts of contingent rent expense. We expect that in the normal course of business, leases that expire will be renewed or replaced by leases on other properties.

**(9) Subsequent Events**

On February 2, 2015, GCI purchased ACS Wireless' interest in AWN and substantially all the assets of ACS and its affiliates related to ACS's wireless business (the "Acquired Assets") for a cash payment of \$293.2 million. The Acquired Assets included all of ACS Wireless' equity interest in AWN, substantially all of ACS's wireless subscriber assets, including subscriber contracts, and certain of ACS's CDMA network assets, including fiber strands and associated cell site electronics and microwave facilities and associated electronics. GCI did not acquire certain excluded assets specified in the agreement. GCI assumed from ACS post-closing liabilities of ACS and its affiliates under contracts assumed by GCI and liabilities with respect to the ownership by ACS Wireless of its equity interest in AWN to the extent accruing and related to the period after closing. All other liabilities were retained by ACS and its affiliates.

For the current reporting period, subsequent events were evaluated through March 3, 2015, which represents the date the financial statements were available to be issued.